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INTRODUCTION
TO
PUBLIC FINANCE

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"Je n'impose rien ; je ne propose même rien ; j'expose"
DUNOYER

THIRD EDITION
COMPLETELY REVISED AND ENLARGED

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PREFACE TO THE THIRD EDITION

IN its third edition, this book has been revised throughout, partly rewritten, and considerably enlarged. The statistics and other illustrative data have been brought down to date, and discussions have been introduced of some of the more important of the fiscal questions which have come into prominence since the first edition was written.

By using the book with his classes in Public Finance at the University of California, the author discovered many points in which he thought it might be improved. He has, also, gratefully adopted many suggestions kindly offered by his colleagues who have used the book in other colleges and universities. During the period that has elapsed since the publication of the first edition, the author has had much experience at first hand with the actual administration of public fiscal affairs. This experience was gained both in his home State, California, and in the Philippines. This intimate contact with taxation in the doing and in the making has, on the one hand, modified the author's views, and on the other hand should have aided him in his endeavor to make the book more useful to officers concerned with taxation and to legislators and their advisers.

In addition to the general revision outlined above, the following items may be specifically mentioned: the definitions and explanations intended to aid the beginner have been sharpened and clarified, and many new ones have been added; more space is given to French taxation; the chapter dealing with the American general property tax has been entirely rewritten from a new point of view and very much enlarged; the description of that "great engine of the revenue," the British income tax, has been revised, primarily with a view to making it more easily understood by American readers; Henry George's "single tax," although still disapproved, is much more sympathetically treated; appendices have been added to two of the chapters, giving an outline of the valuable work done by the United States Census Bureau on the classification of public expenditures and of public revenues; and inasmuch as the first edition seems to have found quite as many readers in England as in America, the effort has been made in the selection of new material to choose those things which may be of equal interest in both countries.

LUCERNE, SWITZERLAND, August, 1909.

PREFACE TO THE FIRST EDITION

THIS Introduction to Public Finance is intended to be an elementary text-book. It contains a simple outline of those things which are necessary to prepare the student for independent research; a brief discussion of the leading principles that are generally accepted; a statement of unsettled principles with the grounds for controversy; and sufficient references to easily accessible works and sources to enable the student to form some opinion for himself. The references that are given are not so much for the purpose of sustaining the author's statements, which any advanced student or teacher can easily trace to their sources, as to enable the beginner to add to his information on points that are of necessity briefly treated here.

Both the American and the English systems of taxation are badly in need of reform. Public opinion is gradually awakening to this need. Financial questions are widely discussed. There can be no doubt that the most pressing reforms of the close of the nineteenth century are tax reforms. The rapid extension of governmental functions—the invasion by the government of fields of activity that lie near to the welfare of the people—has given rise to great interest in the financial side of

these activities. It is hoped that this work may be helpful in the accomplishment of these needed reforms.

The Introduction to Public Finance can be intelligently studied by any person already familiar with the general principles of Political Economy. Technical details and wearisome tables of statistics have been avoided wherever possible. Abundant references to statistical compilations are, however, given, so that such matters can be readily looked up if wanted. The countries whose financial systems have been chiefly used to illustrate principles are England, Germany, France, and the United States; other countries have been drawn upon only for particularly pertinent examples. A brief but complete history of the financial practices of the four countries named has been given. The countries most extensively studied are England and the United States. Although the book has been written from the point of view of an American, the author ventures the hope that it may not prove the less useful to English students.

CARL C. PLEHN.

BERKELEY, CAL., August, 1896.

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INTRODUCTION TO PUBLIC FINANCE



INTRODUCTION

SECTION 1. Public finance deals with the way in which the State acquires and expends its means of subsistence. It stands in somewhat the same relation to the State that economics stands to the individual. If economics were defined as the science which deals with the activity of the practical reason in acquiring and applying those things that are provided in comparatively limited quantities, for the satisfaction of the external and temporal wants of man, then, adapting our definition to somewhat the same terminology, public finance would be defined as the science which deals with the activity of the statesman in obtaining and applying the material means necessary for fulfilling the proper functions of the State.¹

Definition.

¹ When used by itself, without a modifying adjective, the term "finance" often has a broad meaning, and may cover not only the receipts and expenditures of governments, but also matters relating to the capital, income, and expenses of corporations, associations, partnerships, and even of individuals. By metonymy it is applied also to the forms which the several items just named may take, and to the business transactions through which they may pass.

Public finance may be called a science, because, (1) it deals with a definite and limited field of human knowledge; (2) it admits of an orderly arrangement of its facts and principles, and contains many laws of general progress belonging exclusively to its own field; (3) it admits of the application of scientific methods of in-

*Properly
called a
science.*

Thus it includes money, notes, bonds, stocks, etc., and transactions therein, together with all the forms and methods of banking. In common usage, "to finance" a transaction, whether conducted by the government, by an association, or by an individual, is to provide the "funds," which may take the form of taxes, money, evidences of indebtedness, or records of investment, for the furtherance of the transaction. Thus Cleveland's book on the *Funds and Their Uses* covers matters that are in this sense "financial." To guard against ambiguity, it is customary to designate each of these various uses by some appropriate adjective. Thus we have "corporation" finance, "trust" finance, "private" finance, "public" finance, and many other kinds of finance. When used without modification, as in Bolles' book on American Finance, and in his *Financial History of the United States*, or by Dewey in a book with the same title, it covers public receipts, expenditures, and indebtedness, and also money and banking, in so far as these have been the subject of governmental concern and formal action. Yet, on the other hand, Adams' *Science of Finance* deals exclusively with matters relating to public finance.

Of the two adjectives relating to our subject, "financial" and "fiscal," the former has all the ambiguity that is found in the noun from which it is derived, while the usage of the latter is purer. The adjective "fiscal" usually means, relating to public finance, to the exchequer, or to the public treasury. The noun "fiscal" is not in common usage in English, although it has some sanction. It might be used to designate any officer who has to do with the final enforcement, by legal procedure, of the collection of the public revenues. In this sense it recalls the original meaning of *finare*, to pay a fine. Thus in Spanish countries the "fiscal" is a special attorney, or prosecutor, attached to the treasury department. Unless the meaning of the adjective is perfectly clear

vestigation; (4) it foresees as well as explains a certain class of phenomena. That it is generally, if not universally, so regarded confirms this view. It is, however, a secondary or dependent *A dependent science.* science. It is closely related to two

other larger sciences, upon which it properly depends. These are economics and political science. While, on the one hand, it draws largely upon the conclusions of these two sciences for its hypotheses, and for some of its principles, yet on the other it contributes much to them. Most of the prominent German writers on the subject regard public finance as a corporate part of economics, or at least of the older political economy.¹ It is properly so regarded, because the activities of the State which belong to this field are of such a nature as to consume wealth, produce wealth, and to interfere with the distribution of wealth. From political science, public finance has to borrow many conclusions as to the nature of the State, and as to the functions of government. A determination of what the proper functions of the State should be is no part of our subject, but belongs wholly to political science.² In general, it

from the context "fiscal" is preferable to "financial." Thus, it is customary in English to speak of the "fiscal year," but never of the "financial year," when referring to public affairs.

¹The modern conception of economics as a science which has less to do with political and more with individual activities, would, perhaps, exclude public finance.

²For discussions of that part of the subject the reader is referred to Bluntschli's *Theory of the State*, Wilson's *State*, Hoffman's *Sphere of the State*, and Crane and Moses' *Politics*.

has been found best to assume that the functions now actually performed by any government are proper for that government, provided they are not clearly contrary to some generally accepted principles of political science. We are thus relieved of the burden, assumed by many writers on the subject, of attacking or defending the actions of different governments in matters the propriety of which is open to discussion; for example, the propriety of the continuance or assumption of State ownership of railroads, or the State monopoly of tobacco. All such matters will be treated purely from the fiscal point of view.

Information concerning the facts with which the science of public finance deals can, in most instances, be definitely ascertained and the conclusions drawn have often a sharpness and distinctness lacking in many other parts of

*The art of
public
finance.*

political economy and political science. There is consequently a strong temptation to create the corresponding art of public finance. For when any science becomes at all "exact," it is easy and often desirable to point out possible direct applications of the truths learned. But although it is of the utmost importance that statesmen should be guided in their actions by correct principles, it is in no sense the duty of the scientist, as such, to make the application of the laws he may learn. Scientific investigation should precede, and ever remain independent of, any possible use of the truths discovered. In no other way than by the search for truth for

its own sake can we obtain absolute clearness of view.¹

SEC. 2. Public finance, as a science, is older than political economy. Indeed, it is not incorrect to say that it was the forerunner of both of the sciences to which it is now subordinate; *Older than political economy.* for the writings of the cameralists dealt more fully with this part of the field of political economy than with any other. Cameralistic science, or public finance as an art, and as the subject of conscious study, necessarily arose as soon as there was a distinct separation between the income of the Government, or the State as such, and the income of the Prince; that is, as soon as any direct levy was made upon the wealth of the citizens, or any property was administered, to secure a revenue for an acknowledged public purpose broader than the mere support of the Prince's household. The demand for officials properly trained to administer the vast princely and public revenues which flowed into the public coffers led to extensive studies in just this line; and then the investigation into the origin and causes of the wealth of nations, as the foundation

¹This must be regarded as the author's ideal and aim. But he found himself, even in writing the first edition, unable to live up to that ideal, in every instance, and occasionally entered the field of criticism, and advocated some reforms. This edition is still further "marred," or "enriched," whichever way the reader may regard it, by new excursions into the "art of public finance." On account of the strength of his convictions the temptation to voice them has been too powerful to be resisted.

and source of public revenues, was the step which led to the birth of the greater science of economics.

The writers on the cameralistic science (which, because it at first embraced but little more than the matter now included in public finance, may be properly claimed as that science under another name) were stronger in Germany than elsewhere.¹ On this account the science has always had a stronger hold there than in France or England. In

*Only parts of
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those countries the lead of the Physiocratic doctrine, the powerful influence of Adam Smith, and, after his time, the intensity and rapidity of industrial development, directed the attention of students in such fields to the more general and more absorbing questions. Although Adam Smith himself devotes one book to the discussion of finance, and other writers of note give it passing attention, it was extremely slow in obtaining recognition as an independent science. The predominance in both England and France of a theory of State which minimised the importance of government action may account in part for this neglect. The one portion of the subject that did receive general attention — namely, taxation — dealt with an activity that was admittedly necessary. But other fields, like that of expenditure, were comparatively neglected. The tendency of English economists to underrate the importance of a

¹ For an account of them see Roscher, *Geschichte der National Oekonomie in Deutschland*.

study of consumption, except so far as it led to new production, prevented them from seeing anything worth studying in State expenditure beyond, possibly, its effect on new revenues. Hence it is that while Germany piled treatise on treatise, all deep, scholarly, and broad, covering the whole subject of public finance, we had to wait until 1892 for a systematic treatment of the whole field in the English language, and we still await such a one in French.¹ It must not be understood that portions of the subject were not investigated in those countries. There are, on the contrary, many important works on the various parts of the science. But what was entirely lacking until the appearance of Bastable's Public Finance, in 1892, was an attempt to systematise the whole subject.

Financial problems are becoming more important, because the functions of government which depend on them have grown in importance and number. Our industrial, commercial, and social organisation has become more *The recent growth of interest.* and more complex, and it hence requires better and more effective governmental organisation to keep it running smoothly. The more important it becomes to perfect governmental organisation, the more do questions affecting the supply and application of its material support rise into prominence. Whether we regard the constant expansion of the State's

¹ Leroy-Beaulieu, however, covers all but expenditure in a masterly manner.

activities with favour or disfavour, it is equally important that the financial problems arising from these activities should be solved. Consequently Professor Bastable's work has been followed by a flood of special articles and by a number of notable treatises. Especially prominent among such publications in the English language are Professor H. C. Adams' *Science of Finance*, Professor W. M. Daniels' *Elements of Public Finance*, Professor E. R. A. Seligman's various essays and intensive studies of intricate and important questions, and the translations of Professor Cohn's writings. During the past decade many governmental commissions have made extensive investigations and have published their findings in able and instructive reports.¹

SEC. 3. On account of the close relation existing between public finance and economics, most of the

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discussions as to the proper method for the latter bear with equal force upon the former.² But the nature of the materials with which public finance deals is such that in general the inductive method has a wider possible scope, and the deductive a narrower field than in the larger science. The historical and comparative method is most serviceable for ascertaining the conditions under which different kinds of taxation develop. The general effects of taxation, its shifting and incidence, the effect of expenditure and

¹ See Bastable, 3d edition, pp. 36 and 37, for other works. Also Stammhammer, *Bibliographie der Finanzwissenschaft*, Jena, 1903.

² Cf. Keynes' *Scope and Method of Political Economy*.

public debts, can be studied deductively. The deductions in this case are derived from the conclusions reached by the previous method, and from principles derived from political economy. Inasmuch as the purpose of the present book is merely to expound principles already determined by the science and to use the facts of financial practice rather as illustration than as proof of the doctrines advanced, it will not be necessary to acquaint the reader, in each case, with the method used to ascertain the truths stated. In the main, therefore, we shall follow what has been aptly called the method of instruction, which is in a sense an inverted induction, in which the principle is first stated and then sufficient facts are adduced to show that the principle is true.

SEC. 4. The subject falls naturally into four parts: (1) public expenditure, (2) public revenue, (3) public debts, (4) financial adminis- *Division of*
tration. Of these, public expenditure *the subject.*
and financial administration have, until recently, not been the subject of important works in the English language, and, therefore, a few words in defence of their incorporation are necessary. Public expenditure is as much a part of public finance as consumption is of economics. While it belongs peculiarly to political science to determine what the lines of expenditure shall be, just as it belongs to ethics to teach the individual in what direction he should use his wealth, yet, when the lines of expenditure have been determined, its form, amount, and effect belong

to public finance, just as the form, amount, and effect of consumption belong to economics. Consumption, or the satisfaction of wants, is the end and aim of all production and distribution. So is expenditure the end and aim of the collection of revenues and of the other financial activities of the statesman. To exclude, at least, a statement of the forms and the cus-

Expenditure should be included. tomary direction of expenditure would be to overlook the purpose of all the rest. But there is still another consid-

eration that emphasises the need of a statement of the general objects of expenditure. The amount of expenditure is generally determined first, and after that has been settled the required revenue is obtained. In this public finance differs materially from economics. In the broader science it is generally assumed that the individual cannot regulate his income by his wants, but must limit his wants to his income. In some cases this difference fades away. Cities often have to forego, temporarily at least, desirable improvements on account of the increased burden they would impose on the finances. But in general we find that the modern State is quite as likely to neglect some important and desirable function which it could perform, as to increase its functions beyond what would be wise.¹ If this is true, and that it is so will be seen in the course of the discussion, then it would be well to ascertain the main features of expenditure at the outset. But we

¹ Cf. Cohn, *Finanzwissenschaft*, p. 183.

are not obliged to justify or condemn the different lines of expenditure that are deemed by the leading nations to be wise or expedient.

Financial administration is properly regarded as the fourth division of the subject, because it is as necessary to know *how* the State gets its revenues as to know *whence* it gets them and *for what* it spends them. This department, too, deals with a large number of technical details which would only cumber the other parts if taken up in connection with them.

Of the four divisions, public revenue is necessarily the largest; probably for reasons akin to those that influenced previous English writers to give taxation their exclusive attention. It is here that the most urgent reforms are pending, and hence the need of understanding existing conditions is most pressing.

Needed reforms make public revenue the most important part.

The distribution of the various financial activities among the different divisions of the government, federal, national, or local, will be noted in connection with the discussion of each part of the subject.

SEC. 5. In the present work the attempt has been made to use the same method of classification from beginning to end. The method used is that suggested by Professor Cohn for all public charges, and afterwards developed in a somewhat different way by Professor Seligman.¹ The charges made by the

Uniform method of classification for all parts of the subject.

¹ Cohn, *Finanzwissenschaft*, pp. 104-118, esp. pp. 117, 118; Seligman, *Quarterly Journal of Economics*, May, 1892 and 1895,

government upon individuals are regarded as varying in character according as the special benefit conferred upon the individual is made the exact or the partial measure of, or is not allowed to affect at all, the burden imposed upon him. Public revenues and public debts have already been classified in this way, and it is very easy to classify public expenditure and administration in the same way.

The nature of this classification and its applicability to the whole subject may be illustrated by reference

The nature of this classification illustrated by the practice of athletic clubs. to the well-known customs of large athletic clubs. For membership, and the usual privileges of the club, each member is assessed the same sum, irrespective of the actual extent to which he uses the club, and without reference to his ability to pay, that being assumed, for this purpose, to be equal to that of every other member, and certainly without reference to any known ability to pay more. This fee is justified by the common benefit conferred. If, however, the member makes use of the dining-room, or asks for special privileges, such as the private use of the club quarters, grounds, boats, appliances, etc., he pays an additional sum, measured, generally speaking, by the special benefit conferred upon him.

Essays in Taxation, Chap. IX. Hints of the same classifications are found in Malchus and Hoffman. See, also, Plehn, Classification in Public Finance, *Pol. Sci. Quar.*, March, 1897, and Nicholson, *Principles of Political Economy*, Vol. III., Bk. V., Chap. IX. Especially important and illuminating is the "Appendix," beginning on page 146 in Bastable's 3d edition.

Again, if the club is in debt, or proposes to enlarge its facilities, not infrequently a subscription paper is passed around and each member is urged to contribute, not the same amount all others have subscribed, nor yet in proportion to the use he makes of the club, but "as much as he is able." And lastly, there are not infrequently cases where poor but promising athletes have been admitted, in order that the club may have the glory of their prowess, and have been excused from dues.

Now there is an almost perfect analogy between such a club and the State in respect to the contributions demanded, the benefits conferred, and the method of operation. Generally speaking, the State endeavours, in collecting revenues, to impose an equal¹ burden upon all for the support of those functions that are regarded as conferring a common benefit, and a special burden for the support of those activities which confer a special benefit, and under certain circumstances to increase the burden imposed upon the very wealthy, who are regarded as able to bear more; and lastly, to tax all for the support of the poor. Not that the State always succeeds in its endeavour, nor that all States recognise equally the desirability of the attempt; for in public finance expediency necessarily plays a large part. But most States have come to recognise more or less clearly these ideals, and their policy can be conveniently summarised in this way.

¹ What is meant by "equal" will be discussed later.

The various activities of the State can be easily classified, according to the degree of common or special benefit they are supposed, by the lawmakers, to confer upon the citizens, or taxpayers. The various groups may blend or shade into one another at their margins, but those activities belonging to the centre of each group are easily recognisable and are fundamentally different in each. Thus, it is universally admitted that the functions of the general administrative and legislative departments are of such a character as to give a common benefit, for which, ideally, every one should pay according to some scheme of supposed equality. But at the other extreme there are many things done by the State which confer so special a benefit as to justify a special charge. For example, when the State carries a passenger or a box of freight over its railroad, or carries a letter, or provides the citizens with china or tobacco, it confers a special benefit. Between these two extremes there are any number of grades, according as the predominant thought is that of common or special benefit, when both ideas are present. But there is one more consideration that must be introduced. There are a certain number of State activities which it is in the interest of the whole to have performed, but which accrue to the special benefit of certain classes, who on account of poverty are unable to pay for that benefit; and if the State is to perform these functions, it must call upon the other classes for assistance, ex-

cusing the poorer. Theoretically, the support of the poor and defective classes is an activity conferring a common benefit upon all the other members of society, and hence they are called upon to contribute accordingly. If we consider it the moral duty of society as a whole to help the weak, then the relief of the poor confers a common benefit. It is the same if we look upon poor relief from a less altruistic point of view, and consider that society is merely protecting its own interest, as, for example, in isolating the feeble-minded, so that they shall not propagate their weakness. Without going farther into details which will receive attention later in the book, it is now clear that this conception provides a feasible way of classifying public activities and public revenues. When we once have a satisfactory classification of revenues, it is easy to classify debts, inasmuch as they rest upon the revenues. The administrative features of the financial bureaux will fall naturally into place also.

A single method of classification will, therefore, pervade the work from beginning to end which will help us to get at the economic features of expenditures, reveal the justification and measure of taxation, and show us the essential character of each kind of public debt; namely, the kind of credit upon which it is based.

*Advantages
of this classi-
fication.*

It must not be understood that the assignment of any activity to a particular group is permanent.

Activities that were once regarded as conferring special benefit — as, for example, a large part of the administration of justice — come in time to be regarded as of common benefit. Such changes sometimes proceed with rapidity, and the stages are not passed through synchronously by all States. There are, for example, many

The attitude toward public activities changes. A general movement toward the idea of common benefit.

cities which let private individuals provide the water supply. Others provide it themselves, on precisely the same terms as individuals would, while others provide it much as they do other special privileges, regarded as conferring both special and common benefits; and very probably the time is near when some large cities will regard it quite as much a matter of common benefit to provide each and every citizen with at least a certain amount of water, paying the cost out of funds derived from the general taxes, as they now regard it a matter of common benefit to dispose of the sewage, a function which was once considered the duty of each citizen, and is still so regarded in some cities. But however mutable our classes may be, they are clearly discernible, and it is generally only by slow degrees that functions move from one end to the other of the systematic grouping.

While there seem to be general tendencies, which transfer all activities from the special benefit to the common benefit plan, there are a few exceptional cases where the movement is the other way. The

support of religion is such an instance. Originally almost the sole object of State expenditure, this has now, after passing through various ups and downs, come to be regarded as of such special benefit that it is being gradually excluded from the sphere of the State, and left to private support.

Some activities cease to be regarded as of common benefit.

PART I

PUBLIC EXPENDITURE



CHAPTER I

THE NATURE OF THE STATE AND ITS FUNCTIONS

SECTION 1. The STATE is the centre of public finance. The State requires money and services for the performance of its functions. The first question is, What is the nature of the State, and what are its functions? To answer this we shall have to borrow a little from political science. The best authorities on political science seem to answer the question, "What is the State?" with a more or less expanded but not essentially modified restatement of Aristotle's famous dictum: "It is manifest that the State is one of the things that exist by nature, and that man is by nature a political animal." The State is an organism into which the individual is born, and through which alone he can hope to reach his highest development. Upon its existence, and the perfection with which it performs its functions, depends the degree

of social organisation possible. The State seems to be God-given to enable society to organise on a grand scale for the accomplishment of practical ends far beyond the reach of the individual,—ends upon which the welfare of the individual depends.¹

The two opposing theories as to the proper sphere of the State, Individualism and Socialism, stand for two grand truths. The one for the truth that the individual, if he is to accomplish his manifest destiny, must be allowed and assured room enough for the free exercise of his powers so as to develop them, and to expand. Such individual development is necessary for the advance of society. The second is that the State affords the individual the surest means of obtaining the assistance of his fellows, so necessary to his own complete manhood. The way of reconciling these two theories is pointed out in the Christian doctrine that true freedom consists in perfect obedience to the law. Anything short of perfect obedience to the highest law is failure to attain the highest freedom.

The constant intrusion of the State on fields of activity previously given to the individual is a natural result of the constant increase in the separation of employments, necessitating more extensive organisation. As the individual becomes more and more depend-

*Individualism
and Socialism
reconcilable.*

*The extension
of State func-
tions not jus-
tifiable a priori.*

¹ Cf. Kidd, *Social Evolution*; for detailed analysis of the nature of important modern States see Burgess, *Political Science and Comparative Constitutional Law*.

ent for the completeness of his own life on his fellows and their faithful performance of the duties assigned to them, the organisation of the State becomes correspondingly more perfect. As regards this increasing importance of organisation, the following will fairly summarise the practice of advanced nations. It is impossible to approve on *a priori* grounds of every intrusion of the State into fields hitherto set aside for the individual. Only when such intrusion does not lessen individual power, energy, ambition, and ability to advance, is it permitted. And only when it promises definitely to increase the importance of the individual, in the long run, is it desirable. The burden of proof is, therefore, in each concrete case thrown upon the persons who would have the State advance into new fields. There is no absolute limit to, but only a general presumption against, the assumption of new functions by the State.

SEC. 2. If political science cannot in the nature of things give us any definite, theoretical limits to the expansion or the contraction of State functions, can such limits be found in public finance? If the

Does public finance set any limit to the possible expansion of State activities?

common statement that "the State regulates its income by its expenditure and not its expenditure by its income" is altogether true, there can be no limit set by public finance to the possible expansion of State functions. But there are, as a matter of fact, many important exceptions recog-

nised.¹ Those exceptions are: (1) that statesmen in deciding as to the advisability of any new expenditure necessarily consider the amount of burden it will impose on the taxpayers. The expansion of municipal activities in the last twenty-five years has been so rapid that at present any further expansion is, in many instances, at least temporarily checked by the difficulties in the way of meeting the cost. (2) There are some instances where for political reasons income has outrun what was regarded as wise expenditure, and new ways of spending have had to be devised. This is a decidedly more unfortunate state of affairs than the other, for such forced expenditure seldom takes a wise direction. Witness the wholesale plundering of the United States treasury for pensions. (3) Expenditures may sometimes rise very rapidly, and necessarily so, at a time when it would be extremely unwise to attempt to increase the revenues. At such times the practice of nations—a practice that has proven itself wise—has been to let expenditure run beyond the income and borrow the difference.

One of the prime requisites of a good system of public revenues is that the sums taken from the people each year in the various ways shall be as steady as possible. The reason for this will be made clear under the general consideration of revenue. That fact, however, forbids our determining the annual reve-

*A limit set by
the requisite
of steadiness
in revenues.*

¹ Cf. Bastable, p. 42; Wagner, I, sec. 11.

nues absolutely by the annual expenditures. The general practice of nations is to increase expenditure, (a) when it is absolutely necessary, (b) if not absolutely necessary, when it offers advantages which more than compensate for the increased burden on the revenues. The experience of nations has also

Practice of nations recognises a limit. shown that it is universally better to do the public business, if expenses are increasing rapidly, on a deficit rather than on a surplus. If expenses are for a considerable period quite uniform, the usual policy is to keep the revenues, as nearly as possible, equal to them, but not in excess of them, and when expenses can for some reason be lessened, some of the revenues may be applied to the amortisation of accumulated deficits. It would seem, then, that steadiness of revenue is treated as the more important consideration. Herein lies a limit, but not an absolutely fixed one, to the expansion of expenditure and of State functions.

To sum up: the general character of public expenditure, especially as to whether imperative or not, as well as to its particular direction, will depend primarily upon considerations which belong to political science. *Summary of the argument as to the limitation of state functions.* Its amount will depend on the revenue-yielding strength of the State, and upon the effect which such expenditure will have thereon. The danger made so much of by some writers¹ lest,

¹ Roscher, sec. 109.

revenues being obtainable by compulsion, that compulsion be exercised for the benefit of interested persons, who gain particularly by the increased spending, is in a democracy replaced by the corresponding danger lest too meagre supplies be granted by the voters who must themselves pay the larger part of the revenues, and advisable or even necessary lines of expenditure be omitted or seriously curtailed.

SEC. 3. Expenditure, like every other feature of public finance, changed radically in character and direction during the eighteenth century. Therefore, before proceeding to analyse present expenditure, we shall do well to take a brief survey of expenditure before this century. In the early stages of State life the forms of property were few, public life was identified with the family and with religious life. There was little call for definite public expenditure. The chief item was for religious observances, and for these purposes only was there a distinct public treasury. Foundations for the support of religious observances, as seen in Greece and Rome, are extremely old. The temples have their own groves, lands, mines, and flocks, receive contributions, and collect payments for their services. Materials for the study of this period are scant. Services of a public character are performed by all citizens as a matter of course. In war they are the warriors; they furnish their own arms. Their reward is in the success of

Public expenditure in early times.

their enterprise. By mutual effort, or by the slave labour of conquered peoples, they build their fortress-cities, ships, roads, and temples. The simplicity of economic life and the absence of a money economy forbid the rise of any proper system of public revenues. Taxes are levied on conquered peoples, but the free citizen is usually exempt. There is practically no division of labour in State matters which would call for a paid public service. Greece and Rome emerge from these primitive forms with a more complicated system of expenditure, but with relatively little advance in revenues.

SEC. 4. In Athens we find a highly developed system of expenditures, almost communistic in character, and greater than that of other nations of Greece on account of the sources upon which the city treasury might draw and the peculiar circumstances in which the city was placed.¹ The expenditure for public buildings and public works was particularly large, as were the extravagances of public festivals and sacrifices, of donations to the people, compensations for attending the assemblies, and the like. Peculiar to Athens, among all the nations of that era, was the assistance rendered at the public expense to the poor and especially to the children of those fallen in war. Regular expenditures are said to have varied from 400 to 1000 talents, or from \$410,400 to \$1,026,000. Extraordi-

¹ The outline in the text is necessarily very brief ; for a longer account see Boeckh, *The Public Economy of the Athenians*.

nary expenses in time of war were relatively small on account of the rendition of voluntary services by the citizens.

In Rome there was no distinct public budget in the earlier days of the republic.¹ The public wealth was not distinct from the private wealth of the citizens. With the increase of the provinces and the receipt of tribute from them came regular *Expenditure* methods of public expenditure. The *in Rome.* items directly borne by the State were the cost of the priesthood, of buildings and other structures and roads, of the army, of the general administration, and of the distributions of food, of grain for the city population, and donations of money, oil, and wine. The army was first paid in 406 B.C. But for a long time afterward the remuneration amounted to little more than the reimbursement of expenses. At first the Emperor was supposed to live from his own private property, but as he had control of all the public revenues, the distinction was difficult to maintain. The later courts were extremely extravagant.

Greek, and especially Roman, expenditure had many features similar to modern expenditure. In classic civilisation, division of labour was sufficiently developed to render possible the payment of those who devoted all their time and energy to *Division of labour and public expenditure.* public affairs. But continuity of development is lacking. From the fall of Rome to the rise of feudalism there is a reversion

¹ See Marquardt, *Römische Staatsverwaltung*, Bd. II.

to the earlier forms of public life. Public expenditure is not separable from private. The citizen serves the State without remuneration, and there are no public expenses proper.

SEC. 5. It is the essence of feudalism that all governmental functions are placed in the hands of officials who are given the possession of lands which yield the necessary revenues for the execution of those duties. At the same time the relation between these rulers and the people is such that services can be commanded for public purposes without distinct remuneration. The undeveloped condition of commerce and industry necessitates that public contributions shall be in products and in *Feudal ex- penditure.* services. The chief duties of a public character that are performed by these semi-public officials are the organisation and leadership of military operations and the crude administration of justice. Of administrative functions in our modern sense there are scarcely any. The public funds are so entirely under the control of the prince that he comes to regard them as his own. At the same time the various subordinate lords, who were originally officers of the crown and who received lands for the purpose of supporting them in their offices, succeed in retaining possession of the lands and other rights and privileges, although neglecting the duties for which they were given. As the monarchical State emerges from feudalism there is the same complete identification of the public purse with the

private purse of the monarch as there was of the State with the person of the monarch. And this, too, although a good share of the revenues are now derived from taxation. Expenditure is for the gratification of the prince, and so far as he sees that his interest is the same as that of his people he spends for them.

The advance of constitutional forms of government is everywhere characterised by successful attempts on the part of the representatives of the people, or of those who contribute to the public purse to get control of the finances.

Constitutionalism advances just as fast as it succeeds in these attempts. At present the control of the purse is entirely in the hands of the constitutional legislative bodies in almost all civilised countries, and the domains of the prince, which were originally given him by the people in order that he might be supported in proper dignity in the performance of his public duties, and were then diverted by him to his private enjoyment, have been regained in many cases by those who gave them, and are in most States once more public property. The expenditure for the support of the crown now becomes one of the chief items on the civil list. The final establishment of constitutional government has introduced a new criterion for judging public expenditure. An expenditure is no longer a justifiable one when it gratifies the whim of the ruler of the governing body, but it must result in some clear

Constitutional forms of government change the control of expenditure and consequently its character.

benefit to the people as a whole, or to the nation, or in a benefit that is so regarded; otherwise it will not continuously meet with the popular approval which is now necessary to sanction every governmental action.

SEC. 6. Many attempts have been made to classify public expenditures, and often with good results. The most common are those which follow, more or less closely, the usual economic analysis of private expenditure, according as the wants satisfied are necessary, desirable, or superfluous. The use of economic terms in this way is to be commended, but as in economics, so here, the vagueness and relativity of these terms are very unsatisfactory. Different writers do not agree as to what are necessities, even for the same State. After all, the assignment of any particular expenditure to one or the other of these categories is merely the expression of the author's individual judgment on the expenditure in question.¹ Professor Bastable, realising this difficulty, *Bastable's classification.* proposes a classification based on the order of historical rise of the different functions, or perhaps it would more nearly reproduce his thought to say that he tries to establish historically a sort of natural evolution or sequence of public expenditures. Such a classification is useful, for the purpose of historical treatment, but even there it presents many difficulties. The difficulties arise from the fact that

¹ Cf. Bastable, p. 43.

such a process merely substitutes for the author's judgment, on which the older classifications rest, the judgment of the leaders of national policy at different times and in different places on the same questions: namely, Are these expenses necessary or merely expedient? He certainly gains much by substituting the point of view of past statesmen for that of any present person or persons. But for purposes of exposition it will be a still greater gain if we can eliminate the personal element entirely and make a classification that does not depend upon the way in which the desirability or undesirability of the different functions is regarded.

Such an analysis as we are in search of has been suggested by Professor Cohn,¹ which he has well called the "economic analysis of civic housekeeping." There are, according to this suggestion, four groups. The first consists of those functions which confer so definite a benefit upon the individual, and are so clearly performed solely for the benefit of the individual, that he would naturally be expected to meet the cost of them. The second group consists of those functions which confer a common benefit upon all members of the State, of such a character that it cannot be parcelled out and each portion definitely assigned to the respective members. This group embraces the prime functions of the fundamental institutions of the State. These are the two extremes. Between

¹ *Finanzwissenschaft*, p. 117.

them are two more groups. The third consists of those functions which confer a special benefit that might be separately assigned to particular persons, but in which such assignment is wholly or partly waived, because there is also sufficient common benefit to justify making such functions a total or partial charge on the general ability. Finally, a fourth group, which consists of those functions that confer a special benefit on certain individuals more or less unable to assist in bearing the charges, and which are consequently treated as though they conferred a common benefit upon all the members of society.

Dropping, for the present, all consideration of the ways in which the benefit is measured, which will be fully discussed under the head of revenue, and rearranging the groups in the order of their importance, we have the following four classes of expenditures:

*The four
classes of ex-
penditures
according to
the benefit
conferred.*

First, the largest and most important, those which confer a common benefit on all citizens.

Second, those which confer a special benefit on certain classes that is treated as a common benefit, because of the incapacity of these classes.

Third, those which confer both a special benefit on certain persons and a common benefit on all the others.

Fourth, those which confer only a special benefit on individuals.

Under the first of these come the general expenditures for the support of the constitutional agencies of the government. The support of the administrative and legislative departments, *The items belonging to each class.* in almost all their branches, including the diplomatic corps, and everything necessary thereto, as public buildings, etc. Here, too, belong the support of defence and the maintenance of internal security and quiet. Here belong, according to modern practice, the maintenance of roads, although it was once treated as belonging to class four, and passed through a transition stage in class three. Under this class belong also the chief expenses in connection with the maintenance of the money circulation, although a part of this expenditure is in most countries to be assigned to class three.¹ The same is to be said of the expenditure for education. Here belong the administrative control and assistance of private industry and commerce.

Under class two belongs the care of the poor and the defective. Also the support of the pensioned, unless the pensions are such that they may be regarded as wages delayed in payment, in which case they belong to the first class.

Under class three come the administration of justice, the provision for religion wherever the State has an established church, the general admin-

¹ The United States once charged a seigniorage of one-fifth per cent.

istration of the postal service (sometimes, however, this is in class four), the administration of special rights, like patent rights, copyrights, corporation privileges, etc.; also, the recording of titles, etc., the laying out and grading of streets, building of sewers, etc.; so, also, the water-supply in many cities, although the provision for this is rapidly undergoing a development that will eventually place it in class one.

To class four belong almost all of the great industries carried on by the State or by cities, the monopolies maintained by them for the benefit of their treasuries, etc.

As will be seen from remarks made above in connection with the assignment of certain of these services to the different classes, there has been, and still continues, a certain process of evolution which may be generally summed up as a tendency for all these expenditures to move from class four to class one. There are many instances where expenditures now regarded as naturally and unchangeably belonging to class one were regarded as belonging to class four. When a government assumes any new industrial function, as, for example, supplying water to the inhabitants of a city, that function is usually assigned at first to class four and treated as though conferring a special benefit only. But it frequently comes about that it is regarded as a function conferring a common benefit at least in part, and passes into class three. There are forces at

work which seem likely to place it finally in class one. In the case of highways this transition has been completely made, and, except in the case of city streets, which still belong to class three so far as construction is concerned, but pass into class one as soon as finished, highways are usually treated as conferring common benefit only.

In the following chapters on expenditure the order indicated above will be followed. The arrangement of the different expenditures under class one will be somewhat according to historical origin and importance.

APPENDIX

THE OFFICIAL CLASSIFICATION OF EXPENDITURES BY THE UNITED STATES CENSUS BUREAU

The United States Census Bureau undertook, in 1902, to formulate a general classification of governmental expenses and revenues. This classification was constructed primarily for the purpose of presenting, in a uniform and systematic manner, the statistics of municipal, commonwealth, and national finance in the United States, which it is the duty of the bureau to compile. It was more especially designed for the biennial reports on municipal finances. A secondary purpose was to influence the many accounting officers to adopt a uniform and improved method of keeping their accounts. The classification is the work of the Hon. L. G. Powers, one of the able chief statisticians connected with the bureau, who took the advice of a number of expert accountants and of some committees of the learned societies interested in the subject. The classification has stood the severe test of having been applied to the analysis and presentation of the expenditures of a multitude of cities and of the fifty-one states and territories of the United States. It has thus been proven to be a practical system, and is worthy of careful study. It should be noted, that, although all the cities and states

to which this classification has been applied are in the United States, and might therefore be supposed to present a set of financial systems with many points in common, yet there are so many differences arising from local traditions and differing conditions that the classification has stood a test almost as severe as if it had been applied to the analysis of the expenses of foreign governments.

The following extracts are from the Special Report of the Census Bureau on Wealth, Debt, and Taxation (twelfth census), 1907, pp. 953 ff. All references to the classification of revenues have been omitted here as they are appended to Chapter I, in Part II.

"BASIS OF CLASSIFICATION

"The most fundamental of the many classifications of expenses, outlays, revenues, payments, and receipts of governments is that according to the nature of the governmental activities and transactions with which associated. From the standpoint of the student of economics the activities and transactions of a nation, state, or municipality are of two radically different types; these are here classified as arising from *general functions* and from *commercial functions*.

"The *general functions* of a nation, state, or municipality are those which are, as a rule, performed for all citizens alike, without any attempt to measure the amount of benefit conferred or the exact compensation therefor, the expenses being met by revenues obtained principally from compulsory contributions levied without regard to the benefits which the individual contributors may derive from any or all governmental activities. Most functions of this class are essential to the existence and development of government and to the performance of the governmental duty of protecting life and property and of maintaining a high standard of social efficiency. Chief among such activities are those of general government; the protection of life, health, and property; the care of the defective, delinquent, and dependent classes; the education of the young, and the performance of other duties of a similar nature; the purchase of lands for government buildings, parks, and streets; the erection, equipment, and management of state capitols, county court houses, city halls, and other buildings for general governmental uses; and the purchase or construction and operation of electric light and gas works for the exclusive purpose of lighting

the streets and governmental buildings, and of other structures and plants, such as printing offices, police and fire telephone systems, and bridges; for furnishing free of charge any commodity or service required by the government in the common interest of all its citizens. In the same category are included the opening, grading, paving, and curbing of streets, and the construction of drains and sewers, where such public improvements are made at public expense, without conferring upon particular individuals measurable special benefits for which, in the opinion of the proper authorities, compensation should be exacted by the government. To the same group belong the making and paying of loans and the payment of interest thereon, where such loans are made in connection with other activities and transactions mentioned.

"The general functions of nations, states, and municipalities may be classified in a great variety of ways, according to the point of view from which considered. The primary classification of general functions of municipalities which was adopted by the Bureau of the Census is based upon prior studies of the subject by Professor Adolph Wagner, of Germany, set forth in his *Finanzwissenschaft*, and reviewed by Professor Frederick R. Clow in the *Quarterly Journal of Economics* for July, 1896. The earlier treatment of the subject by American economists was ably discussed by Professor L. S. Rowe of the University of Pennsylvania, before the conference of the National Municipal League in 1899. As a result of these studies and of conferences between accountants, economists, and others connected with the National Municipal League, that organisation arranged a tentative classification which was made the basis of the one later adopted by the Bureau of the Census and used in its statistics of municipal finance in Bulletins 20, 45, and 50.

"The *commercial functions* of a nation, state, or municipality include those which create trade relations, industrial or semi-industrial, between the nation, state, or municipality and the general public, including other civil divisions. Among the transactions which arise from the exercise of such functions are those involving the loan of public money at interest, the use of public property for compensation, the sale of any commodity or article of commerce, or the performance of any work or service for pay. All these transactions involve the performance of some service by the national, state, or municipal government, or the granting of some favour by such government, for special compensation, whether the service or favour be primarily for this service or favour, or for the

revenue to be secured ; none of them is essential to the existence and development of the government, though they may be made to contribute to its support.

“ Commercial functions together with the commercial and semi-commercial transactions which arise from them may be grouped into three subclasses — *industries*, *investments*, and *special services*.

“ (1) *Industries* are those activities of nations, states, and municipalities — as the United States postal service, the national railroads of many European nations, the liquor dispensary of South Carolina, and such municipal activities as waterworks, electric light and gas works, and street railways — which are organised as more or less complete departments or offices of cities for the purpose of furnishing economic utilities to individual citizens, or to other civil divisions, on terms involving such a compensation as may be determined by consideration of public policy. Such activities of cities are generally referred to by British writers as *municipal trading*. Those of nations, states, and municipalities are also frequently called *quasi-private industries* or *enterprises*. As economists use the term, a *quasi-private* industry or enterprise of a nation, state, or municipality is one in which the purpose of realising a net income or profit controls the method of management and determines the charges, as in a private business of similar character. In this strict sense of the term there are few if any *quasi-private* industries or enterprises in the United States, the greater number of national, state, and municipal industries established in America having been called into existence solely or principally to promote the welfare of the citizens. Hence the Bureau of the Census uses the term ‘ industries ’ to include not merely those properly designated as *quasi-private*, as defined above, but all departments, offices, or activities organised by nations, states, and municipalities to furnish utilities to their citizens for a compensation, without exclusive regard to the question of profit.

“ (2) Under *investments* are included all transactions of national, state, and municipal governments connected with the purchase, sale, or possession of real property or securities held exclusively for investment purposes, and the loan of public money to individuals, corporations, or other civil divisions. Such transactions are of two classes: First, those of the sinking, investment, and public trust funds in which or through which the nation, state, or municipality invests money for the sole purpose of deriving interest, rent, or other income therefrom ; second, the transactions of a more temporary

character by which the national, state or municipal government receives interest on current cash deposits and on deferred payments of taxes and special assessments.

“(3) *Special services* include all activities and transactions other than those included in (1) and (2), which are engaged in by nations, states, or municipalities in the interest of the general public, but which confer measurable special benefits — or what are arbitrarily so regarded — upon particular persons, natural or corporate, for which compensation is exacted. These services include the opening of highways; the construction of pavements, sidewalks, drains, and sewers; the sprinkling of streets, and similar services, the payments for which are forced by means of special assessments. In the same category belong also all services or special benefits rendered to private individuals or to other civil divisions under legal regulations, and paid for by fees, charges, rents, privilege rentals, and kindred remunerations.

“It should be noted that special services, as above defined, are always performed or rendered in addition and incidental to the regular work of the various departments and offices. Receipts therefrom are always classified according to the office or department rendering the service, since the corresponding expenses cannot, save in rare instances, be fully separated from the other expenses of such department, office, or industry.

“EXPENSES

“Government expenses and revenues, when classified by the governmental functions with which they are associated, are primarily arranged in groups to which are given the designations ‘General’ and ‘Commercial.’

“*General expenses.* — The general expenses of nations, states, and municipalities are those incurred by their governments in connection with the exercise of their general functions. These expenses and the payments thereof are subdivided according to the office or department on whose account they are incurred.

“*Commercial expenses.* — The commercial expenses of nations, states, and municipalities are those incurred by their governments in connection with the exercise of their commercial functions. They are divided into three groups, corresponding to the three subdivisions of commercial transactions.

“(1) *Industrial expenses* are the total costs of the operation and maintenance of the industries of a nation, state, or municipality,

including the cost of materials used and the interest on loans made specifically for such industries.

“(2) *Investment expenses* are the total cost of administration of the sinking, investment, and public-trust funds of a nation, state, or municipality, including the interest paid on loans made for securities or properties purchased for those funds.

“(3) *Special-service expenses* are the expenses incurred by a nation, state, or municipality in connection with special services performed or provided by any of its departments or offices other than an industry, including the interest on loans which are to be met from the proceeds of special assessments.”

CHAPTER II

EXPENDITURE EXCLUSIVELY FOR THE COMMON BENEFIT

SECTION 1. In this chapter we shall consider expenditure of the first class ; that is, expenditure treated by the government *is* so clearly *Net expenditure.* for the good of all that no special charge is made upon any of the individuals incidentally benefited. From one point of view expenditure of the second class, wholly for the benefit of certain persons, who are, however, exempt from any special payments, the expense being treated as involving only common benefit, is sufficiently like that of class one to come under the heading of this chapter. But it has been made a part of the next chapter in order not to lengthen this one unduly. Both of these expenditures might well be called net expenditures in distinction from those which, unlike them, develop some accompanying revenues.

The first item is that for general administration. Administrative expenditure is for the support of those officers of the government who *Administrative expenditure, the civil list.* have to do with civil affairs. For convenience it is best to limit it to those officers whose functions are absolutely indispensable to the execution of the laws. The officers who will

be included vary, from country to country, with the frame of the government. It has been customary for financial writers, following the lead of the camer-alists, to limit their discussion of this expenditure to that for the crown and court. This is, in England, called the civil list. The peculiar character of such expenditure in monarchical countries makes it advisable to isolate it. But it must be borne in mind that in republican countries there is no corresponding expenditure. The salaries of the highest executive officials in republics are of the same character as those of the ministerial officials in monarchies. In England the civil list for his Majesty's privy purse, household, charities, etc., amounts to £470,000, and if we add the annuities paid to members of the royal family amounting to £48,000, the crown may be said to cost Great Britain nearly \$2,600,000 per annum.¹ In most monarchical countries these expenses were originally met by the revenues from the crown estates. But the revenues from the domains having been absorbed by the general treasury, it became necessary to make provision for the civil list from the general revenues. To the civil list should be added the salaries and other expenses of the ministries, their clerks, secretaries, etc. In federal governments the administrative departments of the component parts or commonwealths, as well as that of the central government, should be included. Finally there are the administrative departments of

¹ These figures refer to 1908.

the local governments. It is very difficult to ascertain the number of such officials and almost impossible to ascertain all such expenses. According to the summary by the census bureau the cost of all the executive departments of the United States was \$16,375,160 in 1902. This includes federal, commonwealth, and local executive departments.

In monarchical governments, and to a certain extent also in republican governments, traditional sentiment demands that the head of the government shall hold a social position of great prominence and perform certain

*Expenditure
on the civil
list largely
ornamental.*

merely ornamental functions, involving considerable expenditure. So that the expenditure for the services of the highest officials is often larger than the sums which would be necessary to obtain merely efficient service. This lavish expenditure may be fully justified on political grounds, but as it involves great waste, both directly and indirectly, by example, it cannot be justified on economic or fiscal grounds.¹ It is a general fiscal principle, applicable as well to this part of expenditure as to any other, that the expenditure should not be larger than is necessary to secure the most efficient service. The justification of this lavishness, therefore, must be found, if anywhere, in the creation of some equal utility recognised by political science. The exceptions made in practice to the general rule of economy do not extend beyond the heads of the administrative departments.

¹ Rau, *Finanzwissenschaft*, sec. 48.

In the subordinate positions the remuneration does not generally exceed and is often below that which must be paid for similar services in private life. Indeed, there is a certain saving, in that many of the positions, especially where the tenure of office is secure for a relatively long period, can be filled at a lower cost than the same services command elsewhere, on account of the honour attaching to them. In those countries where the expenditure for the higher positions is largest much is saved by the lower pay attaching to subordinate positions.

In this connection mention may be made of the diplomatic and consular service, which, while partly conducive to the better performance of other functions, as, for example, defence and the regulation of commerce, is yet properly considered to be subordinate to the executive departments. Here again the traditional opinion, that the dignity of the nation can only be properly sustained by a lavish expenditure on the part of the ambassador or minister, imposes on the treasury burdens far greater than the value of the services rendered, if measured by the ordinary business standards. As the means of communication improve and the general efficiency and reliability of the news agencies of the public press grow, it becomes harder and harder to justify this extravagance even on political grounds. The custom of lavish expenditure for diplomatic services has not been carried to such

extremes by the United States as by other countries. As these positions were formerly more or less of the nature of political prizes, in that country, this has probably been to the improvement of the service. Foreign intercourse cost the United States \$1,583,118, in 1894, and \$3,204,522 in 1902, an increase due to the greater importance of her foreign relations since the Spanish War, while Great Britain paid £531,392, or \$2,585,753, in 1894, and only £490,052, or about \$2,450,000, in 1902, for that service, not including colonial services of practically the same character, which would bring the amount in 1902 up to over £1,000,000. Generally speaking, the executive department costs comparatively little outside of the actual salaries. There are some election and similar incidental expenses, but not many.

To the administrative department belongs the expenditure for the collection of the revenues. Although this is a part of the gross expenditures only, it is properly included in the general accounts so as to render control

*The cost of
collecting the
revenues.*

possible. In 1908 England spent on the collection of the customs duties £1,050,832, on that of the inland revenues £2,416,000, on the post-office gains £17,592,854; the cost of collecting the total revenues of about £154,000,000 is about £22,000,000 or about fourteen per cent. This seems an extraordinarily large deduction, but the amount is large because of the large amount of expenses connected with the relatively small returns of the post-office and the deficits

of the telegraph and some other services. The cost of collecting customs is only a little over three per cent, of collecting the inland revenues less than two and one-half per cent. In the United States the cost of collecting the customs duties was about three per cent in 1893, and five per cent in 1894. The receipts fell off in that period from \$200,000,000 to \$130,000,000, but the expenses did not fall off correspondingly. The cost of collecting the internal revenues in 1893 was about two and one-half per cent, in 1894 it was about three per cent. In 1906 the customs revenues were \$300,251,877, and the cost of collection very nearly three per cent. In the same year the internal revenue was \$249,150,212, which cost one and three-fourths per cent to collect. The internal revenue department reports that the average cost of collection since the creation of the bureau has been 2.76 per cent.

SEC. 2. The expenditure involved in the payment of salaries to legislative officers, when any such are paid, is not the largest part of the expenses caused by the maintenance of such bodies. There are the clerks, aides, pages, etc., in immediate attendance upon the bodies during their session, the expenses of elections, which in this case swell to considerable amounts, the costs of investigations, public hearings, etc., necessary to put the legislature in possession of the facts upon which to base their actions, and the expenses of promulgating laws, publishing speeches, reports, etc., all

The expense of the legislative department.

of which together form no inconsiderable burden on the finances of every nation enjoying legislative government. These expenses also extend from the federal government down to the municipal governments. The desirableness or undesirableness of paying legislative officers for their services is a matter for political science to determine, and depends in large measure upon the traditions of the different peoples. In England relatively little is spent in this way in any of the legislative departments of the government from Parliament down to the parish. But in that country there is a tradition of unpaid public service that gives her much help in this direction. In the United States the direct emoluments and other legitimate expenses of the federal Congress, and the direct and indirect, more or less illegal, raids by the commonwealth legislatures on the treasuries, as well as those made by the city councillors and aldermen, are very large. It has been estimated by Mr. Moffett¹ that in the 52d Congress of the United States it *The cost of*
cost \$4,593,922.60 to maintain the House *Congress.*
of Representatives alone, for one year, exclusive of election expenses, or about \$6285 a day for each day of its existence, including Sundays and holidays. Of this amount \$3,320,000 went for salaries. There were, therefore, \$1,180,000 spent on travelling expenses, clerks, subordinate house officials, and contingent expenses (including about \$100,000 for stationery and newspapers). But this is by no means all.

¹ *Suggestions on Government*, p. 150.

The expenses traceable mainly to this source in the reports of the auditors, of which public printing for Congress is an important item, foot up to about \$7,000,000 per annum, or for the two years of the life of a Congress \$14,000,000. The real cost of the federal legislature to the country is even larger than that, but the items are not easily traceable in the reports, and some of them, like election expenses, are not reported. In 1906 the net disbursements for Congress, one year only, were \$5,555,663, public printing \$5,746,177. Since then the salaries have been raised from \$5000 to \$7500. Directly traceable to the legislative departments of the federal, commonwealth, and local governments were costs amounting in 1890, to \$10,500,000, and by 1902 these had grown to \$12,656,309. The only expenses directly attributable to this source in England are for the officers of *The cost of* the House of Lords, £37,257 (in 1906), *Parliament.* and for the officers of the House of Commons, £55,576; total £92,833. But many expenses attributed to the different departments should be included. The fact that the ministry is at the same time executive and legislative causes a different distribution of the cost, and it is impossible to arrive at an estimate even as accurate as in the case of the United States. England does not print public documents for free distribution, so that the expense for stationery and printing is less than half of that of the United States, being a little over £500,000.

Some mention should also be made of the expenses

involved in the support of local or semi-local legislative bodies. For the United States, there are the State legislatures and the city councils, *Cost of local* and, for England, the local government *councils.*

board and the county and municipal councils. Of these, only the commonwealth legislatures are purely legislative in character. The others perform functions which are better described as administrative. It is so difficult to obtain a correct estimate of the particular expenses for the support of these subordinate bodies as to be an unprofitable task. These bodies, too, are so intimately concerned in the administration of the other functions that we gain little by isolating the mere expenses of their maintenance. With the commonwealth legislatures, however, the matter is different. These are purely legislative. In most commonwealths the *The cost of* legislatures are paid *per diem*, and they *common-* are prevented from running up too large *wealth legis-* *latures.*

bills by the limitation of their term. The *per diem* remuneration and mileage are fixed by law, and range from \$5 to \$10 a day and from five cents to ten cents per mile. A loophole for additional expense is left by the necessity of allowing the legislature to appropriate money for incidental expenses. In some commonwealths, as for example in California, this power has at times been abused to such an extent that the contingent expenses amounted to much more than the mileage, regular clerk hire, etc., combined. Money was spent for the hire of personal at-

tendants on members, stenographers, clerks, etc., for tours of inspection to various institutions, and the like. This abuse became so flagrant in California that it was eventually prohibited by a constitutional amendment limiting the expenses of the legislature. Most of this expenditure contravenes the rule of economy. England in the absence of the federal system is spared this expense.

A very considerable part of the expense of maintaining the judiciary is treated as a matter of common benefit. These expenditures are sufficient to insure the continued existence of the courts, whether they have any litigation before them or not. But as some part, and often a very considerable part, of the costs of actual litigation falls on the litigants, and as the courts are, in most places, almost continuously engaged in work of that kind, it seems more consistent with our classification to treat this expenditure as one partly for private benefit, under class three.

SEC. 3. The construction and maintenance of public buildings for the convenience of the executive and legislative departments and for other purposes is one of the most important although not one of the largest items of expenditure. The construction of such buildings is of course necessary. That they should be imposing edifices, handsomely decorated and equipped, is a matter of national and local pride. That their construction should not be wasteful is self-evident. The

extravagances and theft which have too often accompanied the construction of such buildings in the United States are too well known to need discussion. They are purely abuses and need no further words of condemnation than they have always received. The cost of construction may be regarded as a permanent investment, not yielding a money revenue, but important utilities. The federal government spends annually about \$3,500,000 upon public buildings. In 1902, including new buildings and sites, the amount was \$6,610,475. From 1789 down to 1882 it spent \$85,591,590 for the same purpose, or an average of about \$900,000 per annum. In 1890, all the different branches of the government together in the United States spent \$56,841,147 upon public buildings. The British government spent, in 1894, £1,750,000 on the special account of public buildings, but there are a good many similar expenses included in the other supply services. These expenditures are obviously subject to great fluctuations from year to year, so that the figures given are merely illustrative, not typical.

The exact annual value of these utilities to the government cannot be directly estimated in money. Indirectly it might be estimated as the equivalent of the interest on the sums *The value of public buildings.* which it would cost to replace them in the most economical manner, less the annual cost of the repairs. As, in some cases, the original expenditures were extravagant and wasteful, this method of

computation would result in a smaller sum than the interest on the original cost.

SEC. 4. A nation differs from individuals in that no law can be imposed upon it by any external human power. The enforcement of the rights and obligations of nations in their intercourse with one another is left to the different nations themselves. As long as international law offers no peaceful means of redressing wrongs, war is the only resource. "International law," says Woolsey, "assumes that there must be 'wars and fightings' among the nations." This assumption is universally correct. There are no signs, as yet, in spite of the peace conferences at The Hague, that nations will cease to consider that war, or at least the actual preparation therefor, as its

The cost of defence is unavoidable. sole preventive, is an absolute necessity. The whole theory of the independence and equality of sovereign States, upon which international law proceeds, throws the maintenance of national dignity, honour, and recognised national rights upon the nations themselves. The extent and character of preparation for war in each State depends upon its history, national character, and geographical situation. Thus, the warlike traditions, the mutual distrust, and contiguity of France and Germany, impel to extensive preparation for war, and similar considerations affect other nations of Europe. On the other hand, the traditions, national character, and geographical position of the United States, until after the war with Spain in

1898, led to a feeling of security, and a preparation so insignificant, compared to European armaments, as to call forth continual warnings and protests from military authorities. As a result of the acquisition of territory in the Pacific, and in the Orient, there has been thrown upon the United States the burden of maintaining the bulwark between the white and the yellow races, on the western side of the territory occupied by the whites. The unavoidable expenses for this purpose, while they have not yet reached the magnitude of those of England and of Russia for the defence of the eastern side of their outlying possessions, are already large and are growing rapidly. The necessity and probable continuance of this burden on the finances of nations being thus predetermined, the only task for the student of finance is to ascertain how great a burden this imposes on the treasuries and what possibility there is for some return.

There has been much discussion of the relative merits and economy of the different methods of army organisation. It is pointed out that the German system of compulsory service of all citizens without remuneration shows a much smaller cost, per man, than the English and American system of paid enlistment. But it is urged again that there are in Germany a larger number of expenses involved in the army system than those of the government, as the personal expenditures of the soldiers, the cost to the

Different systems of army organisation.

country from the disturbance of production, the extra costs of enrolment, of free quarters during manœuvres, etc., which do not appear in the budget, but which should be counted in before any fair comparison can be made. It would seem that, in the end, the actual net expenditure for this purpose could only be as much less, per man, as the standard of living of the soldier is less in the one country than in the other. And on this ground it might be urged that the German system, which gives the soldier but little spending money, to waste, and by very strenuous measures inculcates thrift and almost penurious economy, is on the whole the cheaper. How much again this lessens the efficiency, per man, and necessitates a larger number of soldiers is hard to estimate. In England the volunteer system, while adding somewhat to the cost, does not make as heavy drains on the treasury as do the German reserves; but as the expenditure by the individual members of the volunteer service is for a public purpose, it is a part of the cost of the system, and a part that is very difficult to estimate. On the whole no accurate comparison is possible. The actual expenses of the different nations as they appear in the budgets are as follows: England, 1894-1895, army £18,000,000, navy £18,700,000, together £36,700,000; 1908-1909, army £27,459,000, navy £32,319,500, together £61,778,500. United States, 1895, army \$54,500,000, navy \$31,700,000, total \$86,200,000, but this includes over \$16,000,000 for

the construction of new vessels. In 1906, the United States spent on the military establishment \$117,946,692, and on the navy \$110,474,264, together \$228,420,856. Including the amounts spent by the commonwealths the total expenditure for military purposes and the navy in the United States were, in 1890, \$57,544,617, and in 1902 over \$200,000,000.¹ One of the main features of the American system is the establishment of training schools for officers, costing \$360,000 for the military and \$220,000 for the naval academy. In most countries the preparation for war is a source of rapidly growing expenditure.

Aside from maintaining the integrity and the dignity of the State, which are, of course, the greatest conceivable public benefits, the expenditures for the army and the navy yield little direct economic return. The navy protects the citizens abroad and contributes thus to the pursuit of commerce; while the army, likewise, keeps open the channels of internal trade. In those countries where the entire male population is passed through rigid military training, the military system supplements in a very important manner the general educational system and gives valuable mental and physical training. Countries

The economic and social returns for military expenditures.

¹ The exact amount cannot be stated as the census report, the only available compilation bringing together the expenditures of the commonwealths, includes the expenditure for police with those for the militia. The items are: Federal expenses, army and navy, \$154,237,229; for increase of navy \$26,667,104, and commonwealths' expenditure, militia and police, \$54,551,829.

with a small standing army participate in this benefit to a much smaller degree. The existence of a strong military spirit fosters the virility of a people, and hence contributes to its manhood and efficiency in every direction, while the absence of that spirit betokens effeminateness and degeneracy. But these are benefits that cannot be measured statistically, nor in money, and must be left for the sociologists to discuss.

The expenses of actual war are not a part of the regular budget of modern nations. They are always treated as exceptional or extraordinary expenses. Besides the sums actually expended by the public treasury there are many indirect losses and expenses involved. According to the estimates of Wilson¹ the cost of wars to England from 1688 to 1882 was over £1,258,680,000. The estimated cost of the Boer War to England was over £182,000,000. The cost to the United States of the Civil War is hard to estimate. The debt incurred amounted to \$1,845,900,000; \$800,000,000 of revenues were spent during the war; commonwealths and cities spent a part of their current revenues and rolled up debts, and the pensions will probably amount to over \$2,000,000,000; \$6,000,000,000 represents approximately the actual expenditure by all the governmental agencies on the side of the North.

The general preparation for internal peace and security and the prosecution or punishment of the

¹ *The National Budget, etc.*

disturbance of that security by individuals or small groups of persons is a very important *Internal peace* item of expense. Such security is gen- *and security.* erally maintained by the police and the military. In the United States the chief expense is borne by the cities. The states and counties have their own police officers for this purpose, as do also towns not cities. The cost of the police for the whole of the United States was, in 1890, \$23,934,376. In 1902 the combined expenses of the police and of the commonwealths' militia was \$54,551,829.

SEC. 5. The building and maintenance of roads is a source of expenditure which well illustrates the general trend of development. Adam Smith regarded the maintenance of roads as an *The cost of* activity conferring so special a benefit on *roads, a com-* the individual user that he should bear *mon burden.* the burden. Even Bastable places them among the "industries of the State."¹ But the universal tendency is to make the maintenance of roads a common burden because conferring a common benefit. The care of the roads is generally a duty of the local governments, and in the United States the first taxes laid in the colonies, and afterwards in the new states, were for this purpose. The federal government stopped spending much for roads and canals after 1840. In the period from 1789-1882 the total expenditure by the federal government was only \$19,966,465. In the year 1890 the commonwealths

¹ Pp. 193, 194.

and local governments spent \$72,262,023 on roads, sewers, ditches, and bridges. In 1902 this amount, including street lighting, amounted to \$143,198,837.

The maintenance of waterways, roadsteads, harbours, rivers, canals, is also a public function.

Public assistance to navigation. Canals, to be sure, have passed, or are passing, through the same development as roads, and in some respects harbours

and rivers have also done so. In the United States the dredging and improvement of the facilities for navigation in rivers and harbours are the only important items of "internal improvement" that have been consistently held in the hands of the federal government. From 1789-1882 Congress spent \$106,882,717 on rivers and harbours, and in 1890, \$11,737,438 were spent thereon. In 1902 the amount was \$19,590,082. In the same line is the maintenance of lighthouses, signal-stations, the weather bureau, and life-saving stations. The last-named is in some countries supported, in part, by private contributions; in the United States it costs \$1,746,841. The construction of lighthouses, beacons, and buoys cost from 1789-1882, \$77,080,509. In 1894 the lighthouse service cost the United States \$3,250,000; in 1902, \$4,537,316.

SEC. 6. No expenditure commends itself more than that for education. It creates the groundwork of all political institutions. No expenditure in the opinion of Geffcken is more "reproductive" than that which the State makes

The cost of education.

for the development of its future citizens. But the expenditure of the various countries for this purpose cannot very well be compared, because it is very difficult to obtain a complete statement of all the outgo under this head. The local governments generally have certain lower branches under their control and pay a part or the whole of the expense of those. In federal governments the remainder of the system is generally under the control of the component parts. The United States federal government has rendered assistance to the commonwealth and local schools by grants of land of unknown, but very large value, and by the collection and dissemination of information through a bureau of education, and in various other ways. In England the provision for education made by public authorities is generally less than in most other countries, the sole exception being the provision for technical education. Until very recently this line of public activity has been regarded by that country as one conferring a special benefit and to be paid for in part by fees. But it is now pretty clearly the accepted policy of all modern nations to provide at least the primary education necessary for every citizen as a common benefit and to make it compulsory and free to all the recipients. In treatment, then, it is re-

garded as being as much a benefit to the rich childless man to have the sons of his poorer neighbour educated as that he should have the protection of

*Elementary
education
treated as a
common
benefit.*

the police in the enjoyment of his property, and he is made to pay on that principle. In regard to higher education as given in the secondary schools, and technical education, there is no such uniformity of practice. Education in the rudimentary mechanical arts is in fact becoming as important a need of society as elementary education in the usual branches. As the pace of industry becomes more rapid and its organisation more perfect, the possibility of giving this sort of instruction by the old apprenticeship system vanishes. There is no place for the boy in the modern factory. Private initiative cannot be depended upon to supply the opportunity for this sort of education. The State has to do so if it is done at all. In this respect many of the English cities are far ahead of any American city.¹

Whether college and university education should be given the recipients free of charge at the common cost is, in practice, also an open question. *University education not yet treated as a common benefit.* Had not liberal private endowments been made for this purpose, it is probable that the question would long ago have been settled, and that this branch of education would have been treated as the primary was. University education, even though enjoyed by but a relatively small number of the citizens, is quite as "reproductive" and as beneficial to the State as a whole as even a widely diffused system of primary schools.

¹ Shaw, *Municipal Government in Great Britain*.

It is quite as important, if not more important, to have highly trained leaders of public action and thought as it is to have a low degree of intelligence widely disseminated. The university as a centre for research alone is worth many times what it costs if properly conducted. In proportion to the benefits which it confers on the State it is, where run at the general cost, the least expensive part of the whole system. The provision made by many of the western commonwealths of the United States for the liberal support of universities from the public funds has been without exception the most beneficial and economical expenditure they have made. In Germany, too, a large part of the expense is borne by the State. Closely related to education is the maintenance of museums, libraries, picture galleries, and scientific investigations. These comprise in most countries an important part of the provision for education. In 1906 the following amounts were spent in England and Wales for educational purposes : by the local educational authorities £20,403,935, by the board of education out of parliamentary vote £12,604,048. Parliament also voted £1,708,201 for primary schools in Scotland and £1,466,574 for primary schools in Ireland. In the United States in 1890 the total public expenditure for education was \$145,583,115, which was by far the largest expenditure for any one purpose. By 1902 the annual expenditure for education of a public character had increased to \$281,219,278.

SEC. 7. Indirectly all public expenditure aids pri-

vate industry and commerce. But there are many forms of direct aid that are treated and regarded as conferring a common benefit on all alike although accruing to the good of certain persons. Bounties are sometimes offered for certain products. Enterprises of various kinds receive subventions or partial and even complete exemption from taxation. The so-called protective system involves an indirect expenditure of the people's money in the same way. The expense of maintaining the currency, of building and keeping up roads, canals, harbours, and the like, is of the same character. So are many public buildings, as exchanges, markets, slaughter-houses, structures and grounds for public fairs and the like, and commissions and other organisations for collecting and disseminating knowledge concerning horticulture, agriculture, and various industries. The maintenance of a system of weights and measures also belongs here. Besides all those mentioned and some others which are generally treated as expenditures for the common benefit, there are a great many things which the State does for the benefit and assistance of industry and commerce that are regarded as conferring special benefit and treated as such.

The administrative control of private industry and commerce has become a necessity on account of the growing power of modern organisations of capital and the growing importance of the "public" functions which

*Assistance of
industry and
commerce.*

*Control of
private enter-
prise.*

many of these private enterprises perform. The necessity has been widely felt of controlling industrial monopolies, and we have numerous commissions for the regulation of railroads and other public-service industries. To this branch of expenditure belongs also the cost of the control exercised over the production and sale of foods for the protection of the public health. This is mainly an expenditure of the local governments, although it occasionally enters into that of the central government, especially in the case of imported foods. In the United States the federal government has assumed this important function, and many of the states are supplementing its work. The cost of the enforcement of sanitary regulations of all sorts is another expenditure of the same character.

CHAPTER III

EXPENDITURE FOR THE BENEFIT OF INDIVIDUALS

SECTION 1. In this chapter we shall consider the remaining three classes of expenditure. These are not so very closely akin, but have one point of similarity; namely, that they are all regarded as to a greater or lesser extent for the particular benefit of individuals. The first, however, is not so treated by any nation, but is treated as though it were an expenditure for the *Charitable benefit of all.* The relief of indigence and *expenditure.* the protection of society against the insane and the criminal, the care of the feeble-minded and otherwise defective classes, and the care of the sick are among the most costly and most discouraging features of public expenditure. In the United States the expenditure for pensions, charities, and gratuities amounted, in 1902, to \$196,826,069. Generally, even after the State has done all that it can be induced to do, there is still room for private effort in the same direction. The expenditure by private persons and societies for exactly the same purposes is possibly larger than that of the government; so that this is one of the heaviest of all public expenditures. The relief of poverty has generally received more attention in treatises on economics than in

works on public finance. But it belongs very properly to the latter science as well. It is generally a local, rather than a national, expenditure, but on account of its vast size and economic importance has often received the attention of the central authorities, and is in many cases, at least partly, under their control. There is almost no expenditure that fails so signally to accomplish anything like permanent results. As frequently administered, poor relief has aggravated the very evils it has been intended to relieve. The words of Malthus are still true: "We have lavished enormous sums on the poor, which we have every reason to believe have constantly tended to aggravate their misery."¹ Yet the expenditure is necessary, indeed imperative, and will be so as long as the present sentiments on the subject prevail, unless we can remove the causes. That this may be done by the extension of educational facilities, especially technical schools, is a frequent contention. The systematic relief of poverty in such manner as to lessen its evils has recently become the study of scholars and of able administrators and some progress has been made. The student of finance need not enter into the question of the causes nor of the cure of poverty. Indigence there is, and the State has assumed the duty of relieving it. The modern methods of relief are fast coming to be as economical and efficient as the conditions under which they are necessarily administered admit. Like war, this is a

¹ *Essay*, p. 438.

form of expenditure that shows little tangible result that can be measured in terms of money.

The general principle applied in the granting of continued assistance to the poor is that the cause *The principles governing the granting of assistance.* of poverty to be relieved must be such that it cannot be removed by the individual efforts of the candidates for assistance. In other cases, only temporary assistance is rendered. Those who can help themselves are desired to do so. The four agencies which really work together toward the same end are the civil, the ecclesiastical, the associated,¹ and the individual. These should all work harmoniously and should avoid duplication of work. The assisted persons should, so far as possible, be put under conditions which will enable them to help themselves to the limited extent that they are able. The repression of vagrancy and the punishment of wilful paupers, who are really able to support themselves but unwilling to do so, is left to the courts.

Although poor relief is mainly a local duty, Great Britain contributes £710,000 annually from the central treasury for "non-effective and charitable services"; of this, however, over £500,000 are for pensions. In the United States in 1902 public charities alone (not including pensions) cost \$58,400,000; but this sum does not include the value of provisions, etc., raised on the poor-farms, or at the workhouses, of which no accurate estimate can be formed.

¹ Associations or leagues of charitable organisations.

Very different from the older sort of poor relief is the institution of old-age pensions on the insurance plan. Such institutions, for example, as the German, for compulsory insurance may be made self-supporting and in time promise to relieve the State of a part of

*Insurance
against old
age.*

the burden of poor relief. Still different in principle is the old-age pension system adopted in England in 1908. Under this system it is provided that every man or woman, who has attained the age of seventy years, and who has been a British subject and had his or her residence in the United Kingdom for twenty years, and whose means do not exceed

£31 10s. (or about \$150) per annum, shall be entitled to receive a pension.

*British old-
age pension
system.*

The amount of the pension, which is to vary with the private income of the pensioner, ranges from one to five shillings per week. Funds for the administration and for the payment of the pensions are to be provided by Parliament. This system appears to a foreign observer to amount to an extension of the relief to some persons who would not otherwise receive it, and to a transfer of a part of the expense from the local to the central government. It also seems to take away some of the stigma that attaches to the acceptance of poor relief under the old system. There is some doubt as to the amount that this will cost. It is estimated that 500,000 persons will satisfy the conditions and be entitled to pensions, and that the cost will be about

£6,000,000 per annum. But no estimate is available as to how much this will be offset by the reduction in the cost to the local governments.

Modern society supports the insane and criminal classes at public cost. In this way the greatest possible saving is made. Indeed, the cost need not be nearly as great as it is. To a large extent prisons can be made self-supporting. It is perfectly feasible by a proper division of the field between the different institutions to make the prisons, insane asylums, and the like entirely self-sustaining. Hard labour is frequently a part of the criminal's sentence; the less violent insane can be made to work, and something can be got, by proper supervision, from the feeble-minded and the paupers. By an exchange of products between the different institutions the necessary diversity can be obtained. There is little excuse for the too common uselessness of the labour imposed; the tread-mill and oakum picking of our older prison discipline; the digging of unneeded ditches by the insane, etc. Exchange of products, too, avoids the danger of conflicts with the labour unions, which so often arise when a prison attempts to make a product for sale in the open market. This expenditure is very closely related to the one for the maintenance of internal peace and security. The burden falls mainly upon the finances of the central government, or, in a federal State, upon those of the component commonwealths. The policy of

isolating the defective classes, the insane and criminal, the deaf and dumb, the feeble-minded, and the like, is an economy for society as a whole, and if it can be made to prevent the propagation of these weaknesses, is far-sighted.

Hospitals for the sick are imperative needs in the case of infectious diseases ; they are great blessings and very desirable from the standpoint of expediency in all cases. The opposi- *Hospitals.*
tion occasionally manifested by selfish private medical practitioners to public hospitals is a sufficient proof of their economy. Fortunately the modern attitude of the medical profession is strongly for preventive measures and consequently favours the erection and support of hospitals. Generally this is a local expenditure. Certain branches of the government, like the military and the naval, have generally found it necessary, on account of the large number of persons in their employ, to make provision by hospitals for the care of their own sick. The maintenance of quarantine stations for the isolation of persons coming from infected countries or districts is a national affair. Its cost may at times rise to a considerable amount. But there is no question as to its necessity and economy. In the United States there are arrangements for quarantine between the different States, partly at the cost of the federal government and partly at that of the commonwealths. Quarantine against plant and animal diseases is similar in character, and the expense is met in similar ways.

SEC. 2. Old-age pensions for officials whose lives have been spent in the public service, or for soldiers whose health has suffered, for the good *Pensions.* of all, are but the proper recognition of those services. They may be regarded as sums reserved from the wages from year to year and paid over in this form. In that case this expenditure should be placed under class one. This is the case with most of the pensions in England, and there they are generally correctly classed under the expenditure for the departments to which the men pensioned belonged before they retired. But when this expenditure becomes, as it was in the past in too large measure in America, a means of reward for political services rendered to candidates for public office, it cannot be placed anywhere but in class two, being then an expenditure for the benefit of certain persons considered as though it were for the benefit of all. The rapid increase of expenditure for this purpose in the United States, as well as the curious features of that increase, show that it cannot all be justified by any rule of economy. In this country only soldiers are pensioned. Under general laws, which require only that there shall be sufficient proof that the applicant is entitled to a pension, all those who base their claims on inability to work or excellent services are pensioned. But many others have been pensioned by special acts of Congress. The abuse of the system ceased about 1900, although the pensions granted before that still continue. The

amount of pensions increased after the Civil War, rapidly but irregularly. The following table shows the highest and the lowest points of each fluctuation:

1865	\$ 8,525,153
1869	28,476,621
1871	34,443,894
1878	27,137,019
1880	56,777,174
1883	66,012,573
1884	55,429,228
1889	87,624,779
1890	106,493,890
1893	159,357,557
1894	141,177,284
1895	141,395,228
1896	139,434,001
1897	141,053,164
1898	147,452,368
1899	139,394,929
1900	140,877,316
1901	139,323,621
1902	138,488,559
1903	138,425,646
1904	142,559,266
1905	141,773,964
1906	141,034,561 ¹

¹ The total disbursements for pensions for all wars and for the regular establishment down to 1908 were: War of the Revolution (estimate) \$70,000,000; War of 1812 (on account of service without regard to disability) \$45,694,665; Indian wars (on account of service without regard to disability), \$9,355,711; war with Mexico (on account of service without regard to disability), \$40,876,879; Civil War, \$3,533,593,025; war with Spain and insurrection in the Philippine Islands, \$22,563,635; regular establishment, \$12,630,947; unclassified, \$16,393,945. Total disbursements for pensions, \$3,751,108,809.

Great Britain spends about £550,000 on "super-annuations and retired allowances," in various departments; but special pensions for distinguished services, military and naval, civil and judicial, amount to over £110,000 more, and some others are covered by the supplies for the different departments.

SEC. 3. Under this class belongs also that expenditure which is made for the development of industry by bounties and the protection of home industries against foreign competition. The latter expenditure differs from the former only in that the sums spent do not pass through the hands of the officers of the treasury. The recipients of this assistance collect it directly from the contributors in the shape of higher prices for their wares than would otherwise prevail. With the economic side of this expenditure, and the possibility or impossibility of adding permanently to the wealth of a nation by this process, public finance has nothing to do. But as many important nations practise this form of expenditure, we cannot avoid at least a statement of its character. The revenues derived by the government from taxes on the commodities actually imported will be considered in Part II. But so far as any actual "protection" is afforded the home producer, it is an item of expenditure. In effect it is practically the same as if a subsidy or bounty were paid to the producers out of taxes collected from the consumers of the goods in question. This expenditure is made not so much

Assistance to industry in the form of bounties and "protection."

in the hope of increasing the total wealth of the nation directly as in the hope of obtaining a greater diversity of products, so that in the end the effect will be to increase the wealth, indirectly, by allowing for a greater division of labour, and consequently for more steady and efficient production.

This policy has nowhere been begun as a permanent one, but one of its results is the growth of powerful vested interests

Not begun as a permanent policy.

which make for permanence. Thus bounties are paid directly from the treasury, or protection is afforded to industries which it is hoped will eventually be self-supporting, but which are not so at the time. At different times circumstances have caused this policy to be supported by different arguments. Practically all the most important arguments have been used at different times in the United States, where protection has prevailed with scarcely a break from 1816 to 1909. The oldest of those arguments

is known as the "infant industries argument." It is urged that new, weak industries cannot hope to live if subject

Arguments by which protection has been supported.

to the competition of older foreign industries. At the same time it is maintained that in case of war it would be practically necessary for a country to be able to supply all its own needs. This grows directly into the argument of List, which is in the main to the effect that a nation's prosperity, in general, depends not so much upon the mass of wealth produced as upon the greatest possible diversity of its industries,

so as to develop all possible phases of its national production. Just as the human body is healthier when all the muscles are uniformly developed than when a few are abnormally strong, so, it is argued, a nation is more truly prosperous when all its productive forces are moderately active than when its entire force is expended in a few lines. Later comes the patriotic or "home market" argument, which urges that the home producer has a claim on the custom of the home consumer. Finally this argument has been developed in the United States into the famous "pauper labour" argument, and it is maintained that the home producer has been enabled to pay his workmen higher wages than the same classes of workmen receive in foreign countries, on account of protection, and that to remove that protection would be to reduce the home workmen to the standard of life of the foreigners. This latter argument is largely an appeal to class interests for votes and is not wholly tenable. The infant industries argument, it is generally admitted, is incontestable. The strongest argument in favour of the continuance of this subsidising of industries has been developed from that of List. This may be restated somewhat as follows: if the productive energy of a nation has but a few outlets, as in exploiting natural advantages, there is a great danger that the nation's economic life may become stagnant. If, however, production be diversified, even by an artificial process, it is much easier to keep the current of produc-

tive energy in motion, allowing it to be turned in whatever direction new advantages may open up.

In England, which has for many years been regarded as the "classical home of free trade," there has recently been a revival of sentiment in favour of protection. But this movement has not resulted in establishing a protective system in that country. The reasons for the revival of protectionist sentiment are the difficulty of furthering trade relations with countries practising protection and whose home markets are supplied by protected manufactures, and the desire for closer trade relations with the colonies.

While it may be admitted that there is great force in the arguments in its favour, it must be remembered that protection is very heavy expenditure, not less heavy because it is hard to estimate its amount. There is a practical limit set by the wealth of the people to the possible amount of expenditure in this direction. If this process places too heavy a burden on the nation's annual wealth increment, the burden will not be borne, and the end defeated. Again, if the "protected" infant industries finally outgrow the need of subsidies, and fix prices by competition, the drain upon the resources of the country ceases. If they do not, the subsidising process may continue so long as the general mass of the wealth is not thereby too seriously curtailed. A nation may be able to pay for diversification of industries, just as it may be able

*Protection is
a heavy ex-
penditure.*

to pay for schools, for parks, for museums, for libraries, etc. But the limit of such expenditure is set by what the nation can afford. This limit is too frequently overlooked; it is too often forgotten that all protection is public expenditure. No "protection" is afforded unless the price is raised. The difference between the price that would have prevailed and the price that does prevail is the amount the nation spends for this purpose. This is not offset by any direct gain in wealth, and can only be justified by the desirability of having a diversity of industries.

SEC. 4. We now come to those expenditures that are treated as conferring a benefit divided between the particular individual who pays for what he gets, and the people as a whole who pay in the general taxes for the general or common benefit. The first and oldest of these is the expenditure for the courts. The adjudication of disputes between different persons was one of the earliest functions of government. The payment of the costs was originally thrown upon the suitors. But modern governments conceive that it is in the common interest to have justice universally administered. Upon the general and accurate administration of justice depends in great measure the prosperity of business. But either as a preventive of too frequent litigations or on account of the special benefit supposed to accrue to the suitor, the costs are divided, and one part paid by the people,

*Expenditure
for the ad-
ministration
of justice.*

the other — a minor part — by the suitor. In criminal cases the whole cost practically falls on the State; in civil cases the attempt is generally made to assess the cost upon the party at fault. In the United Kingdom, the cost of the judicial system was, in 1902, £797,866 including £133,542 for the land commission in Ireland. Of this total £350,400 was for Ireland alone. A large part of the local administration of justice in England is rendered without emolument by the Justices of the Peace. The United States federal expenditure for this purpose was, in 1902, \$7,350,000. The commonwealths, the counties, and the cities spend about \$40,000,000 more, making a total of over \$47,000,000. Besides the mere deciding of disputes and of criminal cases, the judicial departments perform other legal functions of importance, as, for example, the probating of wills, the disposing of property of intestates, etc. Somewhat similar legal functions are performed for the special benefit of the individual citizens by the administrative branches of the government, as registration and legalising of deeds, mortgages, marriages, and other contracts, the granting and registration of copyrights, trade-marks, patent rights, corporation rights, etc.

In the United States the courts have developed a number of quasi-legislative and administrative functions of great importance. As the interpreters of the federal and commonwealth constitutions, they have had to meet new conditions, and indicate the bearing of the constitutions thereon. They have

often been called upon to interpret the meaning of constitutional customs that have grown up outside of the written documents, and have in this way given those customs a certain degree of legal prominence. They were formerly in some of the commonwealths (following an old English custom) allowed to determine the local tax levy or apportionment. Quite recently, by the use of injunctions, they have exercised a sort of administrative control over industry, especially as affects the relations of employers and employees in industrial monopolies of public importance, as, for example, common carriers. In the control of municipal corporations, both by punishing illegal acts and compelling due compliance with discretionary duties, they have largely performed the functions exercised by the administrative departments in Europe.¹ In all this work they are considered as acting for the common benefit.

SEC. 5. Other functions that are similarly treated need but to be enumerated. Among them are the laying out and grading of streets, building of sewers for the benefit of all the citizens, and the special *Betterment of* "betterment" of the property of abutting property, etc. landowners. The division made here is generally that the first cost is assessed to the specially benefited persons, the subsequent costs, maintenance, etc., to the people, generally. The supply of water is similarly treated in many cities. One of the best examples of this sort of expenditure

¹ See Goodnow, *Municipal Home Rule*.

is that of the post-office, as managed in the United States. This service is almost entirely treated as conferring a special benefit on the users. A part of the cost of the distribution of newspapers within the county in which they are published is treated as a public benefit. In some countries the post-office is so managed as to yield a surplus, in which case it passes into class four.

SEC. 6. Expenditures of class four are part of the gross expenditure only. When a State spends money in wages and in the purchase of a plant and raw materials for the production of porcelain and the like, it expects to get it all back *State* again from the sale of the commodities. *industry.*

The same is true of a city maintaining a gas plant, of a State railroad, etc. Originally, the State made use of public lands, forests, mines, etc., as a source of income, but now there are a great many industries and enterprises which the State conducts more for a public purpose than for the gain to the public treasury. A city does not operate its street railways primarily as a source of income, but to guarantee the citizen good and cheap service. Hence the gross expenditure for this purpose is a very important item. It is growing to be more and more so as time goes on.

Some of the more important industries that the State carries on are for the purpose of supplying itself with certain commodities, as arms, *Manufacture* ammunition, war-ships, and the like. *of supplies.* Such industries are carried on from the highest

branches of the government down to the lowest. We find, for example, many American towns supplying a part of the support of the inmates of its public institutions by cultivating the lands of the poor-farms.

Some of the most striking instances of such industrial expenditure are connected with communication and transport, and with those industries the management of which, on account of the tendency to monopoly, is frequently put into public hands. Examples of this are numerous among those already mentioned. Many industries have been at different times and places so managed as to cost more than they brought in. That is, they have resulted in a net deficit, not a net profit. They thus pass into class three.

A rather significant list of enterprises has in modern times been entered upon by the State, which might be, but are not, managed so as to yield a revenue that offsets their cost. These are museums, libraries, parks, baths, and the like. They belong under class one.

PART II

PUBLIC REVENUES

CHAPTER I

THE CHARACTER AND CLASSIFICATION OF PUBLIC REVENUES

SECTION 1. German writers on public finance generally begin the discussion of revenues with the statement that the State requires services and commodities. The services are furnished by the citizens; in primitive communities freely, by all, in virtue of membership in the State, later by particular ones who are paid for them. The commodities or wealth required may be produced by the State or taken from the citizens. In the ancient primitive community, services are rendered by the citizens as their proper contribution to the State. The commodities needed are for the most part furnished by the individuals without any recognition of a transfer of ownership to the State. The division of labour necessary for the successful administration of more complex affairs of the modern State demands a separation of the

persons permanently in the service of the State from the other classes. These must then be supported from somewhere, and in classical times this is accomplished by giving the State, or what is the same thing in classic thought, its special officers, the income from certain sources, as mines or productive enterprises, and taxes upon tributary peoples, or certain inferior classes of citizens. Out of these funds the public officers were supported, and those in the service of the State who were paid for their services were maintained.

Again, in the middle ages, feudalism furnished a mode of support for public officers by giving them a certain control over land and its occupants. This was a means which, without the use of money, pro-

*Feudalism
provides for
the needs of
the State
without the use
of money.*

vided services and commodities for the public needs.¹ But later as money became more plentiful, and in ordinary transactions payments in kind and in services were commuted into payments in money, the government in turn commuted services due into money payments. At the same time, lands originally conveyed to public officers in consideration of their public services, and to enable them to perform those services, passed absolutely into their control and were treated, in part at least, as their private property, and the services and commodities they yielded became the private income of those individuals and their families. But although

¹ Maine, *Early Law and Custom*, p. 148.

the revenues from the domains, retained in this same way by those families which became the sovereigns, were still applied to public expenses, they soon became insufficient, as the State's functions grew, and other resources were sought. In the mad scramble for public revenues, old rights to dues and services were tenaciously retained by rulers or their officers. Especially were the claims to military and similar general services held. These claims, too, were finally commuted into money payments, which became compulsory just as the services from which they were derived had been compulsory.

The names used for the first revenues, which differed from the receipts from domains and the customary services, show very distinctly

the voluntary character of the payments. They are called beggings, requests, gifts (*beden, petitiones, benevolences, dona*), or from the point of view of the assistance

The voluntary character of the payments beyond the receipts from domains.

given, aids (*aide, steuer*).¹ With the gradual growth of the needs, for which these demands were made, into permanent needs, with the further centralisation and concentration of the public functions, with the neglect of public duties by the feudal lords, and by the quasi-public officers quartered on the land, and with the consequent performance of these duties by the government, the demands upon the people became permanent and compulsory.

SEC. 2. Since the emergence of the monarchical

¹ Seligman, *Essays*, pp. 6-7.

State from feudalism, the trend of public finance has been directed by the growth of constitutionalism, — or the representation of the people in the government. As the whole advance of this movement turned upon the success of the people in obtaining the control of

The growth of constitutionalism results in uniformity in the revenue systems of the different countries. the purse, it is evident that the resulting changes in the financial system must have been very important. The long history through which the different revenues have passed, the necessity of constant compromise between the different

interested parties, and the various changes made necessary by the growth in the economic life of the world, all these have left modern States with a most confused jumble of revenues. Yet with all the irregularities and anomalies that can be found in the revenues of any modern State, there is still in every case a more or less clearly traceable systematic development. This growth of system is clearly due to the work of the representatives, in whose hands the development of constitutional government finally placed the control of the collection and spending of the public money. As these representatives realised the need of revenues, they naturally sought for some principles of right and justice to guide them in the choice of sources. The result has been a partial uniformity in the systems of the different countries.

It should not, however, be imagined that this uniformity is very great, nor that the systems of the

different countries are alike in details. But somewhat the same fundamental ideas seem to underlie all. There are also great differences. Thus one country chooses to obtain the larger part of its revenues from a tax not used at all in another. Historical practices and differences in the frame of government necessitate modifications, *Slight differences in details.* even of the same principle. That bugbear of the student of public finance, practical expediency, which has ruined many a fine theory, works in the most astonishing ways to prevent the execution of approved principles.

SEC. 3. The uniformity above noted came about as a natural result of the general search by the agents of constitutional government for some good reason why, in each case, the particular person contributing should be called upon to do so. As the representatives of the people, they naturally had to satisfy, in some way, the reasonable desire of the people for some clearly defined method of apportionment. As it is generally hard enough to convince men of the need of contributing anything, the plea put forth must be a strong one. If we confine our attention, for the purposes of illustration, to taxes alone, which are the hardest of all revenues to justify, we can see more clearly how the necessity of thus showing good reasons led to uniformity. It is evident that if the representatives had, for instance, informed *Different States find the same justification of taxes.* their constituents that "taxes are one-sided transfers

of economic goods or services,"¹ they would have had considerable difficulty in getting consent to any taxes. But when they announced, "taxes are paid in return for the benefits conferred upon you by the government," it was easier to collect them. When they proceeded to assess taxes on the basis of a more or less definite attempt to measure the benefit conferred, or where, in the nature of things, an actual measurement was impossible on some other basis of supposed equality, they clearly had a very good case to present to their constituents. It requires but the slightest knowledge of the history of constitutional legislative bodies to prove conclusively that such was the process of reasoning. And this fully accounts for the similarity of the systems of various countries.

Whenever it was perfectly clear that a certain function conferred a special benefit on an individual citizen, the charge was made on him, and those persons not so clearly benefited were wholly or partially exempt. Thus we have the practice of taking tolls from persons using the roads, of collecting fees from the suitors at court, or making a sale of some privilege or commodity to the citizens for a price, as in the case of granting a monopoly, or the sale of manufactured wares, or of lumber, or ore from the domains. But many of the more important functions do not result so clearly in a special benefit to the individual, and recourse is had to some other mode of justifica-

¹Part of the definition of taxes by Professor Ely, pp. 6, 7.

tion. At first, naturally, the older ideas are developed. The services traditionally due from the citizen to the State, of which that of military service is the most prominent example, are recalled and appealed to. It is claimed that money should be given in commutation of these services. Then the ground is shifted again and again, and many apparently different reasons are advanced. But in all these changes one thing is clear,—the shifting of argument is made in order to enable the use of some new measure of the amount of taxation, and at basis the justification remains practically the same. The citizen is asked to pay, because he shares in the benefits common to him and his fellows. But this common benefit does not suggest any particular measure.

Changes in the forms of taxation are due to the search for new measures.

SEC. 4. Another point of similarity between different nations must be studied historically; that is the feature of compulsion. This feature is old and universal. It is, perhaps, older than any one of the nations and began in that feudal system from which they emerged. The citizen had to be compelled to render his service to the State, whenever the special benefit to him was not clear. That feature the most advanced constitutional governments have retained. There have, to be sure, been instances where States, and especially cities, have had recourse to voluntary contributions to meet the expenses giving a special benefit. But

Compulsion a universal feature.

these soon passed into compulsory contributions. A fine example of the development of a voluntary contribution into a tax is found in the English poor-rate. In the twenty-seventh year of the reign of Henry VIII., 1536, collections were made for the impotent poor (voluntary). In the first Edward VI., 1547, bishops were authorised to prosecute all who refused to contribute for this purpose (compulsion enters). In the fifth Elizabeth, 1563, the justices of the peace were made judges of what constituted a reasonable contribution (compulsion as to the amount). And from the fourteenth Elizabeth, 1572, regular compulsory contributions were levied, and so they have continued.

SEC. 5. We have already classified expenditures according to the character of the benefit conferred.¹

*Classification
of revenues
according as
they are just-
ified by com-
mon or special
benefit.*

Now the almost uniform practice is to collect compulsory revenues from all the citizens for those expenditures that confer a common benefit, or one that is so treated; then to collect special compulsory revenues for a part of the cost from those persons regarded as specially benefited by expenditures of class three; while the revenues for meeting the fourth class of expenditures are raised by the sale of the commodities or services.

Professor Seligman finds that there are three distinct classes of revenues, each resting on a different

¹ See Part I., Chap. I., sec. 6.

justification.¹ The first of these three we shall call taxes. This is a slightly narrowed use of the term. In the broadest sense an exercise of the taxing power of the State occurs whenever a compulsory contribution of wealth is taken from a person, private or corporate, under the authority of the public powers. But such a broad definition of taxes would include, also, the charges for expenditures of the third class levied to pay the cost or part of the cost of a special service. As these are certainly different from those charges levied to meet the expenditures conferring a common benefit, it is necessary to adopt the narrower definition. In this sense, then, taxes are general compulsory contributions of wealth levied upon persons, natu- *Taxes defined.* ral or corporate, to defray the expenses incurred in conferring a common benefit upon the residents of the State. A tax is justified, but not necessarily measured, by the common benefit conferred.

When a distinct attempt is made to levy the charge only where a traceable or assumed special benefit is conferred, and to make it cover the cost,

¹ See Seligman, "Classification of Revenues," in the *Quarterly Journal of Economics*, April, 1893, and April, 1895; *Essays*, Chap. IX. In my opinion Professor Seligman has not improved his classification by the refinements introduced in the second article. Nor is the necessity for distinguishing between fees and special assessments clear. Special assessments are a kind of fee, even within the terms of the professor's definition of fees. Nothing is gained by raising classes logically secondary in character to first place. It is hoped that the simple general outlines of Professor Seligman's classification, as given in the text, may find general acceptance.

or a part of the cost thereof, the compulsory payment is a fee. In the broadest sense fees are taxes, but they are not taxes in the narrower sense defined above. They compose a large and important class by themselves. A fee has a different justification from a tax. A fee never exceeds the cost of the special service rendered. A charge for a special benefit that exceeds the cost is best regarded as consisting of two parts: one a fee, the other a special tax. A fee may be defined as a compulsory contribution of

Fees defined. wealth made by a person, natural or corporate, under the authority of the public powers to defray a part or all of the expenses involved in some action of the government, which, while creating a common benefit, also confers a special benefit, or one that is arbitrarily so regarded.

The third category of revenues has been called "contractual" revenues, or, by the United States Census Bureau, "commercial" revenues. They are more specifically designated by Professor Seligman as "prices." But there are good reasons for preferring the term "rates" as

Rates defined. the general designation of the class. They are the charges made when the government performs some service, or supplies some commodity, in substantially the same manner as that service would be performed, or the commodity supplied and sold, by private enterprise. Thus we speak of railway rates, water rates, rates for gas or electrical current, telegraph and telephone rates, etc. At the same time we speak of

the "price" of Gobelin tapestry, or of Sevres ware. While common usage is not altogether consistent, the charges made by a monopoly are more often called rates than prices. The government generally establishes a monopoly whenever it takes over any industry and refuses to allow its citizens to compete with it. Industries in which it allows competition are rather unusual and exceptional. Hence the term "rate" seems preferable to "price," and will be adopted in this work.¹

If the State has a monopoly, it may act as a private person would and take "all the traffic will bear," or it may forego a part of the possible gain, and the payment becomes or approaches a fee. If the State has no monopoly, it must, perforce, act as an individual would, subject to competition. Every civilised country has these three categories of revenues, and combinations thereof, and no more than these. Every civilised country recognises the same justification for each contribution. Every government appeals to the same motives to induce the payment of each class. In the case of the first two classes the motive is compulsion, in the last the government withdraws and allows the interest of the individual to bring him forward and induce him to

¹ The term "rate" was not used in this sense in the first edition of this book, nor has it yet received general recognition in theoretical works. But it is not infrequently so used in official documents. It should not be confused with the English designation of local taxes which are, in that country, generally spoken of as *par excellence*, "the rates."

make the contribution. This class has been called voluntary. If this term meant merely the absence of compulsion,—the spontaneity, as it were, of the contribution,—it would be satisfactory. But generally there is the danger of confusion arising from the implication in the term that the contribution is without return, of the nature of a gift. Hence, in order to show the character of the payment, Professor

Rates may be called contractual revenues, or commercial revenues.

Seligman has called it “contractual.”

There are serious objections to this term also, although it is of such a character as to admit of a technical application very easily. But in lieu of a better and for sake of uniformity we will adopt it. There is less objection to the term “commercial” revenues, used by the United States Census Bureau. But up to the present time the term has not been commonly adopted.

SEC. 6. Thus far, for sake of simplicity, and not to depart from the usage of other writers, we have considered the revenues as practically identical with the money flowing into the treasury. Services rendered

Compulsory revenues are derivative ; contractual are not.

without pay do not belong to our subject.

But still it is not quite accurate to identify the public revenues with the money that flows into the treasury. Money is here, as in private households, but the representative of wealth. When the government compels its subjects to pay contributions of classes one and two, taxes and fees, it does so in order to obtain control of wealth which it takes from the people to consume

for a public purpose. But in the case of contractual revenues the matter is quite different. Here the government simply sells, for money, wealth: material things, privileges, or services which it has brought into existence. The transaction is a simple sale. This is partly true of some fees. The money that flows into the treasury simply takes the place of actual wealth already created or being created by the government. The important thing to note is that rates result in little or no increase in the amount of wealth in the hands of the government, unlike the other cases, but represent a mere change in the form of the wealth already owned. It is not wealth taken from the people to be consumed by the government; but wealth created by the government is turned into money so that it may be more conveniently used. Nothing is taken from the people, for they receive back the equivalent of their money in wealth, over which they then have control as owners. In the case of compulsory revenues the matter is different because they receive back nothing tangible, but simply enjoy the common or special benefits of good government. These benefits are of the same character exactly as the benefits which accrue to the individual when he consumes his own wealth. They are "reproductive," if at all, in the same sense that the consumption of bread by the worker is reproductive. That is no

Compulsory revenues leave the individual in the same position as though he had consumed his wealth. Contractual merely represent a change in form.

sense at all. Just as the aim of all production in the economic world is consumption or the satisfaction of wants, so the end and aim of the compulsory collection of revenues is consumption by the State. Sometimes, to be sure, the government turns these funds into permanent forms of wealth which are slowly consumed; as, for example, roads. Sometimes, too, the government adds to the effective power of the wealth before consuming it, or uses it to produce new wealth; but yet, so far as the individual is concerned, he has parted with his property in a way which leaves him benefited, to be sure, but in exactly the same position as when he spends the same amount for some gratification. Quite the contrary is his position when he buys a piece of china made by the government, for then he has the equivalent of his money. The government, too, is no richer than before, but has its wealth in a form which better suits it.¹ Frequently the government uses the wealth created directly without first turning it into money. This wealth is as much a part of the revenues as any that is sold.

We may now change our terminology slightly, and say that there are three sources of public revenues: the first is collected from all the citizens by compulsion, on the ground that certain expenditures are necessary and confer a common benefit upon all; these are taxes. The second is collected by compulsion from certain persons on the ground

¹ Cf. Stein, *Finanzwissenschaft*, II., 138.

that they are specially benefited by some expenditures ; these are fees. And lastly, the State creates wealth for itself. The wealth thus created constitutes a part of the revenue of the government belonging to the third class. This, whether sold or not, is contractual revenue or commercial revenue, and is received in the form of rates.

SEC. 7. One or two minor matters have to be noticed and our classification is complete. Sometimes States receive gifts, generally for some special purpose. These are now rare and unimportant. The special purpose is usually more or less outside the general functions of the State. Sometimes the State receives property by reversion, or takes property which has no apparent owner. This, too, is an insignificant category. The State may exercise the right of eminent domain and take property for some purpose. Generally speaking, it restores an equal amount of some other kind of wealth, so this transaction results in no net revenue. The State is the recipient of not insignificant sums from fines and penalties inflicted under the penal power. These are compulsory contributions levied with an intent to injure, and differ materially from the other categories. Their nature is clear, and they will receive no further attention. All the receipts of the State come under one or the other of these categories.

Other kinds of revenues, gifts, reversions, by eminent domain, fines, and penalties.

APPENDIX

THE UNITED STATES CENSUS BUREAU'S CLASSIFICATION OF REVENUES

At the end of Chapter I., in Part I., of this work we inserted an appendix concerning the United States Census Bureau's classification of expenditures. The present appendix continues the one referred to and covers what the Census Bureau has to say in explanation of its classification of revenues. For introductory explanation of the importance of this classification see *supra*, *loco cit.*

"REVENUES

"*General revenues.* — The general revenues of nations, states, and municipalities consist of those compulsory or voluntary contributions of private individuals or corporations, levied or collected, to defray the general cost of government, and not conditional upon the performance of any specific service to the individual contributor.

"*Commercial revenues.* — The commercial revenues, or income, of nations, states, and municipalities are those derived in connection with the exercise of their commercial functions; they are classified according to the character of the transactions and activities from which they originate. They are here divided into three subclasses, to which are applied specific designations of industrial investment and special-service income.

"(1) *Industrial income* is the total gross earnings of the industries of nations, states, and municipalities.

"(2) *Investment income* is the total income of the investments of nations, states, and municipalities.

"(3) *Special-service income* is the income derived by nations, states, and municipalities, from special services performed or provided by departments or offices other than industries. It is of two distinct classes, according as it is available for meeting special-service expenses and special-improvement outlays.

"CORPORATE INTERESTS

"The *corporate receipts* of nations, states, and municipalities are the net receipts from revenues and from loans which increase indebtedness. By net receipts is meant the receipts from the sources

mentioned, after deductions for refunds and all kindred duplications by counterbalancing payments and debits classed as 'temporary.'

"Corporate receipts are classified by the Bureau of the Census in five main groups, as follows: Receipts from (1) general revenues, (2) industrial income, (3) investment income, (4) special income, and (5) debt obligations.

"*Receipts from general revenues.* — The receipts from general revenues comprise receipts from taxes, licenses, permits, penalties, fines, forfeits, subventions, grants, donations, gifts, and miscellaneous general revenues.

"In the statistical presentation of revenue receipts the Bureau of the Census has introduced — principally for mechanical reasons, to facilitate the ready presentation of all the facts — certain classifications of revenues differing from those employed by Professor Plehn in his analysis of state revenue systems. The taxes referred to by Professor Plehn as 'corporation taxes' are here presented under the heads of 'special property taxes,' 'business taxes,' and 'other taxes'; Professor Plehn's 'inheritance taxes' are included in this report under the head of 'special property taxes'; his 'income taxes' are here included under the head of 'other taxes'; and his 'business taxes' are here given under the various subclasses of licenses and permits. In the text describing the tables of Part IV., the amounts of all taxes, such as corporation, inheritance, income, and the like, are given separately under the designations of Professor Plehn.

"To furnish a key to the intelligent study of the census tables of financial transactions, there is here presented a concise statement of the classes of revenue included under the various heads of the tables of this report. To present this in a complete form it is necessary to repeat a few of Professor Plehn's definitions.

"A *tax* is a general compulsory contribution of wealth collected in the general interest of the community from individuals or corporations by an exercise of the sovereign power of the government, and levied without reference to the special benefits which the individual contributors may derive from the public purposes for which the revenue is required.

"*Property taxes*, which constitute the most important single source of revenue, are direct taxes upon property, or upon persons, natural or corporate, in proportion to their property, excepting such as may be specifically exempt, because taxed by other methods, or

on account of their public character or from considerations of public policy. Property taxes are divided by the Bureau of the Census into two main classes — general and special. *General property taxes* are direct taxes levied upon property in general, in proportion to its assessed or appraised value; under this head are included all property taxes assessed and collected by methods practically identical with those employed in the taxation of the property of the average citizen. *Special property taxes* are direct taxes levied or collected, or both levied and collected, by methods not applied to property in general; among such taxes are those popularly referred to as corporation taxes, bank taxes, security taxes, and mortgage taxes.

“Under *business taxes* the Bureau of the Census has tabulated taxes collected from persons, natural or corporate, by reason of their business, where such collection is not associated with the granting of a license or permit to engage therein.

“Under the head of *poll taxes* the Bureau of the Census has sought to secure as complete an exhibit as possible of the receipts by nations, states, and municipalities from all forms of per capita taxes, whether levied uniformly upon all males, or graded according to occupation or otherwise; and whether levied as a specific amount against all persons subject thereto, or as a quasi-property tax based upon an arbitrary valuation of polls.

“Under *other taxes* are included *income taxes, taxes on commissions of public offices, litigation taxes, frontage taxes, tonnage taxes, customs taxes, and internal revenue taxes*. The latter are a combination of business and license taxes.

“Under the designation *receipts from licenses and permits* the Bureau of the Census has tabulated all revenues collected from persons, natural or corporate, by reason of the business where such collection is associated with and enforced by the granting of a license or permit to engage therein, and where the granting of such license or permit is a condition to the transaction of business, to the following of a trade or industrial calling, to the performance of any act, or to the beginning of any undertaking.

“The revenues from licenses and permits include — according to the analysis of most writers on public finance — a tax, as already defined, and a fee or charge; the fee is the payment for the clerical labour of issuing and recording the license or permit and of supervising the exercise of the general privilege granted thereby, and the tax is the excess over the fee.

"Both licenses and permits are issued quite generally to assist nations, states, and municipalities in enforcing compliance with statutes, regulations, and ordinances for the preservation of public morals and for the protection of life, health, and property, though, as a rule, this fact is more readily perceived in connection with permits than with licenses. Of general privileges granted chiefly for enforcing police regulations and classed in the census report as licenses, mention should be made of dog licenses, good for a year, and permits to minors under the curfew laws, also good for a year. The former is in a class by itself, while the latter is included, together with licenses associated with pleasure or recreation, such as those for hunting and fishing, under the designation *general licenses*.

"Receipts from permits are sometimes only nominal, the amount collected being barely sufficient to cover the cost of issuing and recording them and of supervising the exercise of the general privilege granted. For this reason some writers on public finance classify them as fees.

"In most states revenues collected in connection with the granting of licenses and permits are referred to as 'receipts from licenses and permits'; in a few, however, they are designated as 'privilege taxes' or 'occupation taxes.' The receipts from licenses and those from permits are shown separately in the tables of this report, principally to enable students of the subject, in their analysis of the census reports, to classify permits according to their own judgment. With *receipts from licenses* are included those from general privileges granted for the management or conduct of a business or occupation, such as that of a hotel keeper, a plumber, or for the keeping of a billiard table for gain; such privileges are usually granted for a specified period of time, as for a year, a month, or a day—the greater number being issued for a year. With *receipts for permits* are included those from general privileges granted for the performance of some specific act, the nature of which is exactly defined, and the performance of which terminates the grant, as the erection of buildings, the making of a connection with sewer and water pipes, the moving of buildings, the burial of the dead, and the like.

"*Penalties, fines, and forfeits*, which are among the minor sources of the general revenue of governments, are all collected as punishment for failure to obey civil and criminal laws and local ordinances, and hence might be termed 'penalties,' in the broad-

est meaning of the word. Under this head are included penalties collected by reason of the failure of taxpayers to meet their taxes within the time required by law ; all fines collected by criminal courts ; and forfeits in criminal and civil transactions, such as forfeits in criminal bonds, forfeits in contractor's bonds, etc.

"Under the head of *receipts from subventions and grants*, the Bureau of the Census tabulates as receipts from subventions all amounts which are received by states and municipalities from the nation or other civil division superior to themselves with the distinct understanding that the money so received shall be employed for supporting some particular governmental service, as that of schools, libraries, or armories ; and as *receipts from grants*, those amounts received from such civil divisions without any condition attached to the gift.

"*Receipts from donations and gifts* are those amounts gratuitously paid by individuals or corporations to national, state, and local governments for general and specified governmental purposes. In law the word 'donation,' rather than 'gift,' is most frequently employed in referring to voluntary contributions for specified purposes, made through the instrumentality of a formal deed or contract. So far, then, as donations and gifts have different meanings, the former may be said to approximate that of government subventions, and the latter that of governmental grants.

"*Receipts from commercial revenues*. — The commercial revenues of a nation, state, or municipality comprise the income from industries, investments, and special services. The receipts from *industrial income* are classified with respect to the industry from which they are derived — as waterworks, electric light works, etc. The receipts from *investment income* include the rent, interest, and dividends received from real estate or securities held by the government as investments. The receipts from *special-service income*, other than those derived from special assessments, are subdivided according to the office by which the service is furnished. *Special assessments* are compulsory contributions levied, under the taxing or police power, to defray the cost of a special public improvement or public service undertaken in the public interest. They differ from taxes in being apportioned according to the assumed benefit to the individual for whom the service is performed, or according to the assumed increase in value of the property affected by the improvement.

"The above is a classification, mainly from the administrative

standpoint, of the receipts from the commercial revenues. These receipts may be classified also with reference to their typical form or character. So classified, they are frequently referred to in popular language, in the technical works of accountants, and in legal enactments and governmental accounts as *prices, fees, charges, special assessments*, etc.; these classes of receipts all represent compensation for commodities or services sold or special benefits conferred by the government.

"*Price* is the general designation which writers on public finance give to compensation for service or commodities sold by the government.

"The compensation for a service or commodity sold by a government in the same way that a private individual would sell, is referred to by writers on public finance as a *quasi-private price*; while the compensation for a service or a commodity furnished by a government primarily for the special benefit of the individual, but secondarily in the interest of the community, is designated by them *public price*.

"Public prices are of three distinct classes: They may be (1) what is designated in the commercial world as *monopoly prices*, representing more than the cost of the service or commodity furnished; (2) prices established to cover the cost of the service or commodity; or (3) prices providing the service or commodity at less than cost. In the first case the price includes a tax, and in the second or third it approximates a *fee*; in the first, the service or commodity furnished assists in collecting a tax as a contribution to the general revenue, and in the third, it is in part paid from such revenue. In all cases of public price, the free contractual relations of public life are modified by the monopoly exercised by the government.

"Although the distinction given above between *quasi-private* and *public prices*, as well as that mentioned in referring to the three classes of public prices, is valuable from the standpoint of the student of public finance, it cannot at the present time be made of any practical value in the domain of governmental statistics.

"Of the sources of commercial revenue that involve the element of price, mention is made of *sales, interest, rents, special privileges* of various kinds, *sales of such privileges, privilege rentals, labour, manufactures, rates, and tolls*. Of the foregoing, sales, interest, and rents generally come within the definition of *quasi-private price*, the others within that of *public price*. The prices connected

with investments are therefore *quasi-private*; those connected with industries are more largely *public*; and those connected with special service are quite variable, depending much upon the nature of the special service rendered by the individual nation, state, or municipality.

"In tabulating the receipts from sources involving the element of price the Bureau has observed the following distinctions:

"Under *sales* are included sales of real estate of the nation, state, or municipality; sales of securities belonging to their sinking, investment, and public trust funds; and minor sales by the various departments and industries of their discarded equipment, and of material discarded in connection with the different activities of the government.

"Under *interest* and *rents* are included all receipts of nations, states, and municipalities corresponding to those commonly so designated in private finance. Receipts from so-called interest levied on account of non-payment of taxes and special assessments at the time required by law are, however, tabulated as interest when collected at the legal rate of interest in the several divisions collecting the same, and are tabulated as 'tax penalties' when collected at a higher rate.

"*Receipts from special-service privileges* include all periodical receipts, other than general or special property taxes which are collected from individuals or corporations enjoying the special privilege of using the highways or for providing some public service, such as that furnished by street railroad, subway, electric light, telephone, and water companies.

"All receipts from individuals and corporations in payment for special-service privileges sold outright are designated as receipts from *special-service privilege sales*.

"The receipts derived from *special-service privileges* and *special-service privilege sales*, which are commonly spoken of as taxes, differ from taxes in being payments for services and also, in the majority of cases, in being voluntary or contractual instead of compulsory. However, when a payment made by a public-service corporation to a nation, state, or municipality is in lieu of all taxes, or is levied upon franchises classed as property, and at the same rate as other taxes, such payment is included among general or special property taxes.

"Under *privilege rentals* are included all periodical receipts from licenses other than those defined above as receipts from *special-*

service privileges, which, in addition to conferring the privileges usually bestowed by such instruments, grant the use or enjoyment of, or right upon, some property of the government granting the same, as the streets, parks, or public buildings.

"*Receipts from minor privileges* include all periodical receipts collected, without the granting of a license, from those enjoying special privileges in or upon the public highways, other than receipts derived from *public-service privileges* and *public-service privilege sales*.

"All receipts from minor privileges sold outright are designated as *minor-privilege sales*. It is to be noted that practically the only respect in which *minor privileges* and *minor-privilege sales* differ from *privilege rentals* is that privilege rentals always involve the issuance of a license, which in the other cases is not issued.

"Special-service privileges, privilege rentals, and so-called minor privileges differ from general privileges, as granted by licenses and permits, in that while the bestowal of the four classes of privileges always involves the right to conduct a business or perform some act, the bestowal of a special-service privilege or a privilege rental or minor privilege gives — what the general privilege does not — the right to use some property of the nation, state, or municipality making the grant.

"All receipts included under *labour, manufactures, rates, and tolls* are derived from services or commodities furnished by the industries of nations, states, and municipalities. Receipts from *labour* include the receipts for work performed by convicts in penal institutions and by inmates of charitable institutions. Receipts from *manufactures* include the receipts from the sale of articles manufactured in penal and charitable institutions. Receipts from *rates* include all payments for water, electric light, gas, and other utilities furnished by governmental industries. The word 'toll' has been used exclusively to designate the specific charges made for bridge and ferry passage across streams and harbours.

"*Fees and charges*, as distinguished from taxes, are compulsory contributions of wealth which are exacted from persons, natural or corporate, to defray a part or all of the expense involved in some service rendered by the government.

"The greater portion of the amounts classified by the Bureau of the Census as fees is for services which can be performed only by the governments. They are mainly clerical in character, and their cost is so well established that the payments therefor, which

are made in advance and are often only nominal, are fixed by statute or ordinance establishing a scale of fees.

"In contrast with the foregoing, the amounts classified as charges generally represent payments for services which are similar in character to those rendered by one individual to another in private life, and as a rule are other than clerical in their nature. With few exceptions the amounts to be charged for such services are definitely established only upon completion of the work or service. Among the special privileges of governments paid for by charges are the making of connections with sewer and water pipes and the removal of snow from sidewalks.

"In passing it should be mentioned that a great proportion of the receipts from fees and charges, as tabulated by the census, approximate in character if they are not identical with, those to which is given above the designation of price. However clear in theory may be the distinction between these classes of revenue, in practice they so merge one into the other that the drawing of a hard and fast line between them was found to be as impossible as it was in the case of *public* and *quasi-private* price. The diversity in public policies of different governments produces a corresponding diversity in the methods of performing any given service and of exacting compensation therefor, as has been pointed out by Professor E. R. A. Seligman and many other writers. As a result that which is a 'price' in one city is a 'fee' in another, and vice versa."

CHAPTER II

THE VARIOUS KINDS OF TAXES, FEES, AND RATES ; ALSO DEFINITIONS

SECTION 1. Considerable confusion in the discussions of the different modes of taxation is due to the failure to distinguish clearly between the justification of taxation in general (*i.e.* why there should be any taxes at all) and the measure of taxation (*i.e.* what should be the basis upon which to decide how much each citizen should pay). The universally accepted justification of taxation is the common benefit conferred upon the individuals by the action of the government. But the common benefit is, strictly speaking, equal,¹ while the taxed citizens are unequal in wealth and ability to pay taxes.

¹ "The protection of the subject in the free enjoyment of his life, his liberty, and his property, except as they might be declared by the judgement of his peers or the law of the land to be forfeited, was guaranteed by the twenty-ninth chapter of Magna Charta, 'which alone,' says Sir William Blackstone, 'would have merited the title that it bears of the *Great Charter*.'" Cooley, *Constitutional Limitations*, 5th edition, p. 430. "Equality of rights, privileges, and capacities unquestionably should be the aim of the law ; . . ." "The State, it is to be presumed, has no favours to bestow, and designs to inflict no arbitrary deprivation of rights." *Ibid.*, pp. 486 and 487.

Therefore recourse has to be had to some other measure of taxation. It lay nearest, in the search for such a measure, to overlook the distinction between the measure and the justification and to assume that there was a difference in the benefit enjoyed by the different citizens. Thus one theory assumes that protection to life, liberty, and property *The benefit theory.* is the chief benefit conferred, and that this benefit, or at all events its cost, varies as the property varies, generally in exactly the same proportion. This theory has been called the benefit theory of taxation, because it attempts to estimate by the benefit conferred the amount of tax each individual should pay.

The difficulties involved in measuring benefit, with sufficient accuracy to serve as a basis for taxation, led another school of thinkers to abandon that entirely. These writers feel that each citizen was necessarily a part of the organism of the State, one of the nourishing cells, as it were. And, as in all organisms of nature each organ or each cell contributes to the life of the whole, in accordance with its powers or strength, so each citizen should contribute as he is able. They claim that it is easier to measure ability than it is to measure benefit. This *The faculty theory.* theory is called the faculty theory, the term "faculty" having been found in this sense in early tax laws. Generally speaking, this ability is supposed to be indicated in some way by wealth or by income. But the advocates of

faculty as a measure of taxation encounter a serious difficulty in attempting to ascertain whether faculty is proportional to wealth or income or increases more rapidly as these increase in amount. A negative side of the same idea is presented when it is claimed that the tax should impose an equal sacrifice upon every citizen. In determining what constitutes equal sacrifice, we encounter the same difficulty as in determining how to measure ability.¹

SEC. 2. It will be noticed that the basis from which each of these measures starts is individual wealth. The first argues that benefit is indicated by wealth, the second that faculty is so indicated. If wealth is the basis, then the classification of taxes might be made to depend on that of wealth. Such a method, although tried, has been found impracticable, because the processes of shifting render it impossible to ascertain the final incidence with sufficient accuracy for classification. It has also been suggested that we might use the different specific means employed by nations to measure benefit or faculty. But here again we meet with difficulties that are almost insuperable; for in that case the classification will depend on the theory adopted as to the correct measures. If we adopt

Difficulties in the way of finding a natural classification of taxes.

¹ See Chap. III. for further discussion of this point. A full and instructive discussion of these theories is to be found in Seligman's *Progressive Taxation in Theory and Practice*. See also, Professor Edgeworth's three articles on the "Pure Theory of Taxation," *Economic Journal*, Vol. VII.

the benefit theory, our classification will depend on the different indices of benefit chosen. If we adopt the faculty theory, then our classification will be according to the indices of faculty. But we are not at liberty to adopt one or the other of these theories exclusively, because no nations have done so in practice, and their taxes are some of them based on the one theory, or at least best explained thereby, and some on the other, while many combine both or may be interpreted in either way. At the same time many taxes that could not be justified on either basis are retained by the nations on grounds of general expediency, because they yield considerable revenue, or because they have been long in use. If, therefore, we adopt a classification presupposing either theory, we shall find many taxes that do not conform to it. Inasmuch as no consistent plan for the measurement of taxation has been adopted by any country, no uniform method of classification upon "natural" grounds can be found.

These difficulties are inherent in the matter that we are attempting to classify. The librarian generally desires to arrange his books according to the subjects treated. But *These difficulties are insuperable.* encyclopædias could not be so arranged without tearing the books to pieces. We might theoretically dissect each tax, and assign its parts to the different categories according to the real nature of each part. But we gain little by this painful process. In this case classification will not

help us to ascertain the real nature of the things studied.

These difficulties have not always been regarded as insuperable, and many brave attempts have been made to overcome them, but with so little uniformity as to mark the failure. There are almost as many classifications as writers.¹ The least satisfactory of all are those that attempt to find some natural arrangement. Those which have the most apparent success accept the official names used by the treasury departments of the different nations, and give them merely such limitation as is necessary to use them scientifically.

*Previous
attempts at
classification.*

✓ SEC. 3. Perhaps the most common distinction is that made between direct and indirect taxes. This distinction first obtained theoretical importance in the writings of the Physiocrats. By direct taxes they meant any of those taxes which were levied immediately upon the "produit net."² There

The distinction between direct and indirect taxes is old, and important.

alone, they argued, could be the fund out of which taxes could be paid. To levy taxes anywhere else was indirect, because the burden would be shifted from one to another until it rested there. The assignment of any particular tax to one or the other of these categories was with them a mark of approval or condemnation. With the recognition that other economic processes besides those which added to the

¹ See Nicholson, *Principles of Political Economy*, Vol. III., p. 291 ff.

² Cf. Higgs, *The Physiocrats*.

material property of the world created wealth, this peculiar theory of taxation drifted into abeyance. The same terms, however, have been widely used by officials and writers and have such prevalence that a recognition of them cannot be avoided.

Rau and Wagner have made the most elaborate attempts to define the modern usage.¹ In this they *Wagner's definitions of direct and indirect taxes.* were only partly successful, because of irregularities in official usage. But despite these irregularities the terms are valuable. Wagner's distinction is practically as follows. There are two ways in which direct and indirect taxes differ. (1) In the case of direct taxes, the taxpayer is also the tax-bearer, at least in the expectation of the law-giver; any shifting of the burden to another is not expected, not desired, and sometimes, even, forbidden, or subject to penalty. Indirect taxes are, *vice versa*, those in which the taxpayer is not permanently the tax-bearer, or is not intended to be; but a shifting of the burden to another is expected and desired, and may even be prescribed.²

But the element of shifting is not the only one that is essential to the idea. The second characteristic is what may be called the technical, administrative conception of direct and indirect taxes. It is based on the method of procedure. (2) Direct taxes

Administrative conception of direct and indirect taxes.

¹ Cf. Bullock, "Direct and Indirect Taxes," *Political Science Quarterly*, Vol. XIII.

² Wagner, *Finanzwissenschaft*, II., 1st ed., p. 269; 2d ed., secs. 97-100. Schönberg's *Handbuch*, 3d ed., III., p. 171.

are such as are laid regularly according to some fixed fact (or one so treated, and at least somewhat fixed), something regularly recurrent, and hence previously ascertainable,—a fact as of personality, of rank, of property, of earning, etc.,—and are, consequently, assessed according to some list or roll (cadastre). Indirect taxes, on the other hand, are such as are laid according to some changing, temporary, more or less accidental fact which is, consequently, not previously ascertainable,—something the result of processes, events, transactions,—and are laid and collected according to tariffs.¹

These two methods of distinction follow quite closely the usages of theoretical writers and of official bureaux. There are important exceptions in some countries. Thus in France the customs duties are not officially classed as indirect taxes, but form a class by themselves *Exceptions in official usage*. akin to direct taxes. In the United States at the time of the Civil War the income tax was viewed by the courts as an indirect tax, or at least not as a direct tax in the sense of the Constitution.² This decision, however, was reversed in 1895, by a bare majority of the same court, which decided that a somewhat similar income tax was a direct tax in the

¹ Wagner, *Finanzwissenschaft*, II., 2d ed., p. 239.

² *Springer v. United States*, 102 U. S. 508. See article, "The Direct Tax of 1861," *Quarterly Journal of Economics*, July, 1889; Seligman, "The Income Tax," *Forum*, 1895; Bullock, "The Origin and Effect of the Direct Tax Clause," *Political Science Quarterly*, XV., p. 470 ff.

meaning of the Constitution. This decision was in accord with the distinction made above.

The principal direct taxes are: the land taxes, building taxes, property taxes, poll taxes, class taxes,

Taxes belonging to each kind. income taxes, industry taxes; the indirect taxes are: the custom duties (with the exception of the French), internal excise taxes, transaction taxes, most fees and licenses.

The inheritance taxes, or death duties, as they are called in England, are not easy to classify. In the first sense they are direct taxes, and in the second they are indirect. This is, perhaps, the only impor-

The inheritance tax hard to classify. tant tax that cannot be easily classified. The inheritance tax wherever it exists is used because it is expedient and without

much cost yields a large return. It is levied at a time when the persons paying it are not in position to demand a strong justification. It is sometimes justified on the ground that it compensates for previously unpaid taxes. If this justification holds, then the inheritance tax must be classed as a direct tax.

SEC. 4. A few other terms which are often used as the names of different groups of taxes and help,

Taxes on persons, property, or income. in a way, to classify them must be mentioned in this connection. We sometimes speak of taxes as being separable

into (1) those on persons, (2) those on property, (3) those on income. These terms do not indicate the final source from which the tax is paid, but the basis upon which it is levied.

1. In the case of personal taxes the different persons who are to pay the tax are listed and assessed either (1) individually, as in the case of *per capita* taxes, or (2) as representatives of a group, as in the family or hearth taxes, or (3) according to some characteristic, as rank in life, office, *Personal employment, age, income, property, etc., taxes.* supposed to be indicative of the benefit they receive from the government or their ability to pay. A complete system of such taxes might be built up, and it is possible to suppose that all the requirements of justice could be met thereby.

2. Taxes on property are those taxes which take the property owned by a person as the index either of the benefit received or of the ability to pay. These taxes may be considered as pursuing property wherever it is to be found with little or no regard for the personality of the owner. *Property taxes.* They are not, of course, in any but the most exceptional instances, paid out of property. But no particular regard is had to the real source of payment. They may be levied upon any and every kind of property. They are sometimes called real taxes from *res*, things. But this usage has no established sanction in English; in that language real taxes are taxes upon real estate.

3. Taxes on income in the broadest sense are all those taxes which make wealth in the process of acquisition the basis of assessment. *Income taxes.* These are of two principal kinds: (1) those

which are levied upon the annual increment of wealth as such, irrespective of the person who is the recipient thereof. That is, they treat the various items of wealth increment as the basis of taxation without regard to the grouping of these increments into a whole in the income of any particular person, and consider the person paying the tax only in so far as he is an income producer through his own activities. This is the character of the British income tax.

(2) Those which demand of each person, or seek to obtain concerning each person, a summary of the total income he receives. This latter tax is sometimes so treated as to make it difficult to distinguish it from a personal tax, for the different persons are listed and classed according to amount of income they receive.

By a peculiar and entirely unwarranted use of common English terms in a strange and foreign sense, property, income, and the like have been called the tax objects, and the corresponding taxes objective taxes, meaning that they are taxes on things in distinction from taxes on persons. On the other hand, the persons are called the tax subjects, and personal taxes called subjective. This usage, although it has the sanction of a great authority, in Bastable, has fortunately not been favourably received. Seligman, in a review of Bastable's book, pointed out that by the object of a tax we usually mean the purpose of the tax, and

*Subjective
and objective
taxes. An
unallowable
distinction.*

the tax subjects may be things as well as persons subjected to the tax.¹

SEC. 5. Following the lead of Adam Smith, various attempts have been made to classify taxes according as they fall upon one or the other of the different shares in distribution,—rent, interest, profits, and wages. But, as Bastable has well shown, the sources from which the different taxes are paid are generally a combination of several of these. The wealth or income of very few persons consists of simply one of these shares. The attempts to carry out such classifications consistently have failed. Bastable's attempted compromise by calling such taxes as can be traced directly to one or the other shares in distribution primary, and all others secondary, brings us to practically the same results that were gained by Wagner in the discussion of direct and indirect taxes. His primary taxes are those called direct taxes above, his secondary are the indirect.

*Classification
of taxes, ac-
cording as
they fall upon
rent, interest,
profits, or
wages, fails.*

One other important set of distinctions must receive our attention, because it has the sanction of two prominent authorities. Wagner suggested and Cohn accepted the classification into taxes paid out of wealth at the time of its acquisition (*Erwerb*), or while in possession (*Besitz*), or upon its consumption (*Verbrauch*). This distinction, according to

*Taxes on ac-
quisition,
taxes on pos-
session, and
on consump-
tion.*

¹ *Political Science Quarterly*, VII., p. 717.

the stage in which the tax finds the wealth from which it is paid, is often useful in showing the effects of certain taxes.

Another very valuable distinction is that made by the term "taxes on revenue." Taxes on revenue are those that fall or are assessed on the revenue or income yielded by different kinds of property. These are a species of taxes on acquisition.

The three sets of terms which we have used in this work are: (1) direct and indirect taxes; (2) personal, property, and income taxes; (3) taxes paid on wealth at acquisition, in possession, and at the time of consumption.

SEC. 6. We now come to the important task of classifying fees. The essential consideration to be held in mind about these payments is that they cover a part of the total cost of certain governmental activities, which are performed for the benefit of all, but yet confer a real or assumed special benefit on the individual. When the payment covers the whole or a little more than the whole cost, it is a rate. Since fees are levied upon the receivers of certain benefits from the government, it follows that the only classification for fees is that which shows what activities of the government convey the benefit. We can thus classify according to the different departments of the government, for the services of which fees are collected.

1. The most numerous are the judicial and legal fees, the character of which has already been made clear from the discussion of the nature of these expenditures.¹ Examples of these are the regular court costs and fees, probate fees, the charges for recording deeds, mortgages, contracts, marriages, etc.

2. Next come the administrative fees for the special services of that department. They are : police fees, charged for the special benefits accruing or supposed to accrue to individuals from the exercise of the police power of the State; the fees for education, when charged; a large number of industrial and commercial fees for services rendered individuals in their industrial and commercial undertakings. The industrial fees include license charges for permission to carry on certain businesses (care must be taken not to confuse these with police fees, nor with business taxes assessed on the same plan). Commercial fees include road and canal tolls, harbour dues, and a number of similar charges.

A very important class of administrative fees are those known as special assessments, or in England as "betterment" taxes, usually levied for local improvements affecting property, as streets, sewers, etc. Seligman has defined these as follows: "A special assessment is a compulsory contribution paid once and for all to defray the cost

¹ See Part I., Chap. III., sec. 4.

of a specific improvement to property undertaken in the public interest, and levied by the government in proportion to the special benefits accruing to the property owner." He regards them as of so much importance as to make them a class of revenues coördinate with taxes and fees. Strictly speaking, they are fees.

SEC. 7. The revenues derived from the rates charged for the services rendered by the industrial activities of the State, or from the production and sale of commodities, so long as these enterprises

The nature of public rates. are conducted for profit, are of the same general character as the earnings of the people. Early writers on public finance

devote a great deal of attention to the income of the State from the public domain, forests, and mines, which were at one time of great relative importance. These have shrunk in importance, in modern times, but in their place have come the earnings of the so-called "public service" enterprises, like the railroads and the street railways, telegraph and telephone service, water works, and others of a similar character. As stated in another connection, these enterprises are usually monopolies. Even when they are not of such a character that they would be monopolies even under private control, the government makes them monopolies by refusing to allow any private enterprise to compete. The French tobacco monopoly affords in part an example of this. Industrial enterprises conducted by a government for profit, under competitive conditions, are rare. The general analysis of these

earnings, whether monopolistic or competitive, can be found in any good treatise on Economics and need not be repeated here.

Public rates, however, differ in some respects from the charges made by similar private enterprises. The differences can be most readily shown by an illustration. Let us suppose that a certain city is supplied with water by two private companies, both of which have the right to lay pipes wherever they wish. They will then supply water, supposing that they actually compete, at rates determined mainly by the costs, which are those of management, *Example,* interest on the "plant," the cost of water, *the water* and of the supplies and the general run-*supply.* ning expenses. The average rates will be considerably higher than need be by virtue of the duplication of the plant, etc. Suppose, however, before any material duplication is reached the companies unite, forming one company which has the monopoly. The charges will now be regulated by "what the traffic will bear," and provided the supply is ample will tend to conform to those rates which will yield the largest net returns. The principles by which monopoly rates are regulated are well known to students of economics. The charges in this case cannot be greater than the cost to the citizens of operating their own wells, nor even so high as to induce the citizens to economise materially in their use of water. But suppose that the townspeople are not content with the rates or with the service. They

attempt regulation and fail. They may determine to buy out the plant. Once the city owns the

*The four
methods of
public man-
agement.*

plant it may run it in one of four ways.

(1) It may run it as the company did, to make the highest possible profits, charging all or nearly all the traffic will bear. The surplus over costs goes into the treasury and helps to defray the other expenses of government. The rules determining what the traffic will bear are rules of pure economics. There is absolutely no difference between this public business and a private business. The method of "charging what the traffic will bear" is the method in economic life of determining the value of commodities so sold. It takes the place in the sale of monopoly goods of the "free dickering of the market" by which the price of other goods is determined.¹ The private company had to pay expenses, so does the city; the private company enjoyed a surplus or made an "unearned increment," so does the city; the private company spent this surplus to the satisfaction of the wants of its stockholders; the city spends the surplus for the benefit or for the satisfaction of the general wants of the citizens, who may be regarded as its stockholders. Even if it foregoes taking quite all the surplus, the principle is the same. A private company sometimes does that in deference to public opinion. (2) The city

¹ See Sidgwick, Bk. II., Chap. X.; Andrews, *Institutes of Economics*, p. 122; Marshall, *Ec. of Ind.*, pp. 180 ff.; Senior, pp. 103-114; Sumner, *Essays*, p. 46; Hadley, *R. R. Trans.*, p. 100; Seligman, *Railway Tariffs*, etc., pp. 8 ff.

may decide not to make money, but to charge only what the service costs and make the service as good as possible. It then foregoes taking the full price of the wealth that it has produced and allows each consumer to enjoy the surplus. Then the payment by the citizen is a fee. (3) It may charge a fee much smaller than the cost, or a fee for all water consumed over a certain amount, but provide a certain amount of water for each citizen at the common cost. (4) It may distribute the water free of charge and pay for it out of the common fund derived from taxation. Now the sums received in the last three cases only are fiscal in character.

In this connection it is important to note that there is a strong tendency for a government to abandon the economic, or profit making, method of managing such enterprises and to pass to some one of the fiscal methods. That is, the government's method of conducting a public service does not usually continue to follow that of private management. Thus, for example, it would be natural, and perhaps proper, for a private water company to keep a "large capital account" and to carry a heavy interest or dividend charge against the earnings. But when a government has paid off in whole or in part the debt contracted when it acquired the plant, it is not uncommon to drop the interest charge and to reduce the rates in proportion to the reduced costs. The reason for making such an enterprise a government function is

*The tendency
to abandon
rates for fees
and fees for
taxes.*

the recognition of some public interest or benefit, and, for the same reason, the fiscal method of administration is the more appropriate. Some writers have even gone so far as to suggest this as a sort of test as to whether any given enterprise should be taken over as a government function. They say, in substance, that if the people are not willing to see the enterprise in question conducted on fiscal principles, they should not make it a government function, for it will probably pass on into one of the three fiscal methods of management above outlined and may in time reach the last.

As Cohn has so well pointed out, it is a very different problem that we have to deal with when the management of some industry is made merely the form or means for collecting a tax from certain classes of persons. *Taxation by means of industrial monopoly.* The French tobacco monopoly, for example, is not in any sense to be looked upon as an industry undertaken in the common interest, or even in the interest of a particular class. It is the aim of the French government to tax the users of tobacco. This aim is attained by other governments through different processes. The form of a monopoly has been found to be remarkably easy, expedient, and successful as a method of indirect taxation.

SEC. 8. This section will be devoted to the definition of terms used in connection with revenues. *Definitions:* The "base." The base of a tax is the thing, characteristic, or phenomenon by the possession of which the

amount that each taxpayer shall contribute is to be measured, or it is that upon which the tax is "levied." The base is not always, although it may be, the source from which the tax is paid. Thus a tax based on property is generally paid out of the income, or revenue, which flows, sometimes from the property, sometimes from other sources, while a tax on income would be, normally, paid from the same income that constitutes the base. The direct taxes are almost always called by the name of the base; indirect taxes are seldom so named. The base is often expressed in units of value; as, for example, \$100 worth of property. It may, however, be expressed in terms of some other units of measurement, as yards, tons, acres, barrels; or again by mere count, as, one poll, one ox, etc. When the base is expressed in terms of value, the tax is sometimes called an "ad valorem" tax. "Ad valorem" When the base is expressed in terms of and "specific" some unit of measurement other than taxes. value, the tax is sometimes called "specific." But neither of these terms is applied to certain kinds of taxes, such as poll taxes, income taxes, or inheritance taxes. Sometimes the unit of the base is complex and arbitrary. For example, in Vermont, the base of the general property tax is each dollar in the "Grand List." But only one per cent of the true value of the property of each taxpayer is "set in the list," while his poll is also "set in the list," at an arbitrary valuation of \$100. This complexity of the base arose, originally, from the custom of fixing an

arbitrary uniform value for each piece of property, as so much per acre of land, so much per head of cattle, so much per horse, irrespective of actual value. Other cases of such complex bases usually have some similar historical origin.

The rate is the amount of tax that falls upon each unit of the base. The rate, whether for specific or ad valorem taxes, may be proportional or disproportional. It is proportional when it is always in the same proportion to the base, whether the amount held by a taxpayer or subject to the tax be large or small.

The important thing to observe in connection with proportional tax rates is the way in which the rate is arrived at. It often occurs that a government desires to raise a definite amount of money by a given tax, but the aggregate of the base is not known at the time this amount is fixed. It may therefore direct that when the aggregate of the base is ascertained, the amount to be raised shall be divided by the aggregate of the base and the quotient, or the rate thus obtained shall be applied in turn to the amount of the base held by each taxpayer, thus determining his taxes. Or again, and this is perhaps more important, a central government may apportion among its local divisions the total amount to be raised, assigning a lump sum to each, and the local government of each division may apportion its share among its taxpayers in the manner above described. In the latter case the

"rate," so far as individual taxpayers are concerned, will vary from one local division to another. When either method is followed, the rate, or even the tax itself, is often called "apportioned." This distinction is especially important in the United States, where most of the state taxes are apportioned in this manner. In many instances, however, the government fixes the rate in advance, and is content to accept the revenues, be they large or small, which the rate so fixed will yield. It is true, however, that even in these cases there is a rough sort of apportionment made before the rate is fixed, otherwise the revenue might be too large or too small. Fixed proportionate rates are sometimes laid down by some superior authority to limit the extravagance of lower governmental bodies.

Disproportionate rates are rates which in themselves vary as the amount of the base held by different taxpayers varies. These rates may be progressive or regressive.

Progressive rates are the most important general class of disproportionate rates. This term is applied when the rate is proportionately higher for a taxpayer who is taxable for a large amount of the base than for one who is taxable for a smaller amount. That is, the fraction taken is ever larger, the larger the amount of the base possessed by the individual taxpayer.

Progressive rates may be regular or irregular according as they increase by some fixed mathematical

rule or increase in some more or less arbitrary manner. There are very few regular progressive tax rates in actual practice. Arithmetical, or geometrical progression would give regular progression and so would many other mathematical formulas, notably, some of those of calculus. Of course, many forms of regular progression would, if continued long enough, reach a rate equal to one hundred per cent of the base. As this results in practical confiscation, such an extreme is seldom provided by law. Usually, after a certain relatively high point is reached, the progression is more or less arbitrarily stopped and a proportional rate is substituted. Were the progression to be continued until it resulted in confiscation the motive would not be a fiscal one, for such a policy would diminish the revenue by ultimately cutting down the aggregate of the base. In fact, as we shall see later, the motive for a progressive rate is always something other than the purely fiscal one.

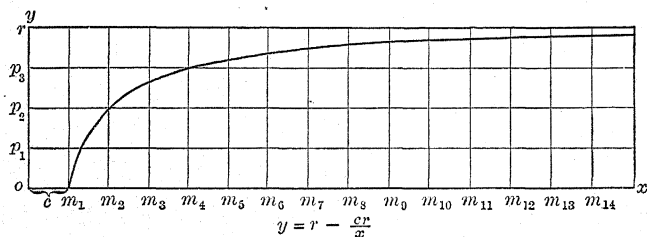
One of the most common, and certainly one of the most important forms of progression is that called "*Degrressive*" "degressive." In this case the rate (as *rates*. distinct from the tax) increases but by an ever decreasing increment. In perfectly regular degression the rate would be so arranged that it would constantly approach but never quite reach a given proportional rate as a limit. It would be cumbersome to accomplish this result by varying the nominal rate. But practically the same end can be

reached by the simple expedient of deducting from each of the ascending amounts of the base a fixed amount, that is, technically untaxed, and applying to the remainder, in each case, a nominally proportioned rate.

Diagram *A* illustrates a theoretical form of regular degressive taxation, which may be regarded as an ideal. The diagram is drawn on the assumption that a constant amount "C" is deducted from each and every amount of the base, be the base large or small, and that the remainder is subject to a proportional tax of "R," which thus becomes the limit, which the rate constantly approaches but never reaches.

DIAGRAM A

A TYPICAL FORM OF REGULAR DEGRESSION



In actual practice such regularity as is assumed in the chart is seldom found. The regularity may be broken by changing the amount of the deduction allowed at different stages, or by cutting it off altogether.

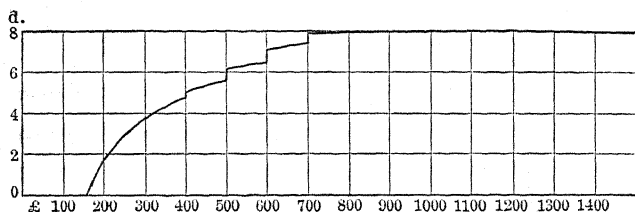
Diagram *B* represents the beginning of the schedule of rates of the British income tax, as it was under

the law of 1898, when the rate was fixed at eight pence per pound. The deductions allowed were £160 up to an income of £400; then £150 up to an income of £500; then £120 to £600; £70 to £700; after which no deduction is allowed. As will be readily seen this carries fairly regular depression up to £700, after which the rate is proportional.

DIAGRAM B

BRITISH INCOME TAX, FORM OF 1898. RATE, 8D. PER £

SLIGHTLY IRREGULAR DEPRESSION, ENDING IN PROPORTION



Progressive tax rates are often graduated; that is, the rate increases by grades or stages of the amounts of the base, and is either proportional or fixed within each grade. From this practice it is very common to speak of all progressive taxes as "graduated taxes." It is probably safe to say that the term "graduated" is more widely used in this connection, and perhaps better understood than the term "progressive."

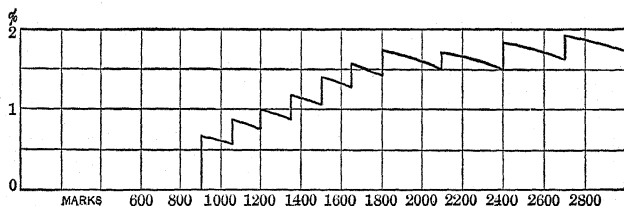
Diagram C represents a somewhat complex form of the graduated tax. But it is a form which with modifications as to details and rates is very frequently

found and is found in connection with many important taxes. The diagram shows the first ten grades of the long series of grades in the Prussian income tax, as it was in 1891. It is a form that is intended, broadly speaking, to result in a series of rates that impose a generally degressive tax. But on account of the fixed rate within each grade, and of the change in rates from grade to grade by round numbers only, the resulting schedule is regressive within each grade, and occasionally regressive from grade to grade. If the rates were proportional within each grade, the chart would show a series of horizontal steps.

DIAGRAM C

FIRST TEN GRADES OF THE PRUSSIAN INCOME TAX, 1891

GRADUATED DEGRESSION, REGRESSION IN EACH GRADE



Many other forms of progressive rates have been devised. They are found in a great many different kinds of taxes, but are most common in income and inheritance taxes. The theory of progressive taxation is discussed in another connection.

The rate is regressive when it is the reverse of the

progressive, that is, when it is higher for the taxpayer who has a small amount of the base than for one who "Regressive" has a large amount. This is usually re-
taxation. garded as an unjust mode of taxation, and when it occurs, it is usually an accidental or unintentional result. Sometimes it is brought about by the evasion or partial evasion of taxation by those who should be the heavier taxpayers. It is occasionally adopted intentionally, as when it is desired to exterminate small saloons and drinking places by a higher license tax than is imposed on the larger ones. It is safe to say that whenever regressive rates are found, they are either accidental or their purpose is distinctly non-fiscal. The regressive rates are in practice never very regular in form, even less so than the progressive rates, but theoretically they can be quite as regular in form as the latter.

It should be noted that graduated taxes are usually regressive within each grade; that is, the tax is a smaller proportion of the base for a taxpayer who
Graduated is just over the lower limit than for one
taxes are re- who is at or near the upper limit of the
gressive in grade. Strictly speaking, every so-called
each grade. proportional tax is graduated and consequently regressive within each grade. This is because the recognised unit of the base, be it a pound, a dollar, a penny or a cent, constitutes a grade and necessarily takes the same rate throughout. But when the unit of the base is small, this graduation and regression is of so little importance that it is ignored.

Impost is a general term for any tax, but there is a tendency to make it synonymous with indirect taxes. *"Impost."*

Customs duties are indirect taxes levied on the goods imported into or exported from certain territories. *"Customs duties."*

Excises (English) or internal revenue taxes (American) are indirect taxes levied on goods produced or consumed within certain territorial limits. *"Excises" or "internal revenue taxes."*

Toll was originally a general term for many taxes, but it has come to have a special meaning, and applies only to the charges for passage over roads, bridges, canals, etc. *"Toll."*

A tax is said to be shifted when the taxpayer reimburses himself from some one else. The final incidence of the tax is the falling of the burden upon some person who does not shift it. *"Shifting" and "incidence."*

Two terms of great importance in connection with taxation are "levy" and "assessment."

The term "levy" covers all the legal processes of imposing a tax and making its payment compulsory. It is an act of the supreme authority of government. "Whatever else it may be," says Mr. John Fiske,¹ "the government is the power that taxes." Conversely no tax can be imposed except by governmental authority. In England and the United States the power to levy taxes is a jeal-

¹ *Civil Government in the United States*, p. 7.

ously guarded prerogative of the legislative department. Two of the commonest provisions of the constitutions of the commonwealths of the United States are in effect: (1) that "the power of taxation shall never be surrendered or suspended by any grant or contract to which the State shall be a party." (2) "No tax shall be levied except in pursuance of law." Only in countries having a system of administrative law is there a seeming departure from this principle.

After the legislative or the equivalent authority has levied a tax, the next step is the "assessment."

"Assessment." This term covers the acts and proceedings of the administrative officers in determining the amount of taxes each taxpayer is to pay. By metonymy it is often restricted, in common usage, to the most important process involved. Thus in the United States in connection with the administration of the general property tax, the term "assessment" is often used as though it were synonymous with the "valuation" of the property.

While legally and logically the levy of a tax involves fixing the rate, and while theoretically this

The levy of a tax is a legislative function. part of the levy can no more be delegated by the legislative authority to any one else than can any other part of the levy,

nevertheless, a seeming delegation of this power often occurs. Thus some executive department may be instructed to ascertain that rate which will yield a certain sum of money, and this rate, although un-

known at the time the law is enacted, is declared therein to be the legal rate. This is only a seeming evasion of the fundamental principle; for the executive department on which this duty is imposed has no discretionary powers and merely makes a mathematical computation, the result of which it has no power to alter. Unquestionably illegal is the not uncommon practice of such executive boards of rounding out the rate to some whole number, or to some convenient fraction, so as to simplify the extensions on the tax bills. But this is such a trivial matter that the courts do not regard the tax levy as invalidated by such a proceeding.

The tax list or roll, which is also known by many other names, contains the record of the assessment. In many cases, notably on the continent of Europe, these lists are, for certain *The "tax list."* taxes, elaborate, permanent or partly permanent records, which may serve various legal purposes as well as the fiscal, as for example the record of titles, and are called "cadastres." When the same tax is used by several different departments of government, as, for example, by the cities, counties, provinces, or other divisions of local governments and also by the State or central government, the initial tax list or the original, may be retained and filed in each local office or tax bureau, and a duplicate thereof sent up to the higher department or division of government. When a number of these duplicates are brought together, the combined list is designated by some distinguish-

ing name, such as the "grand duplicate," the "grand list," or some other similar term.

"Rate," when used alone without the prefix "tax," is a term applied in England to many local taxes, as "*Rate*" mean- the "poor rates," or simply "the rates," *ing a tax.* and in that country often carries the distinction between local taxes and general taxes. In America local taxes for the maintenance of the water systems are not infrequently called "water rates," but the term does not carry the same meaning as in England.

There is a tendency among careful publicists to use the term "rate" to designate the price paid by a consumer for some product of a public industry when the government has a monopoly thereof. Thus we generally speak of postage rates, tele- "*Rates*" as graph rates, railroad rates, water rates, *charges for* gas rates, and the like. The term "price" *public service.* would, if this usage were universal, be applied in public finance only to those charges which are made for goods produced by public industries under competitive or quasi-competitive conditions. If this usage could become universal, it would be conducive to clearness.

CHAPTER III

THE TAX SYSTEM

SECTION 1. No nation has ever found it feasible to adopt any single tax as the sole source of its income. No nation at all advanced in civilisation has attempted to conduct its government entirely from the earnings of its domains or industries. Every civilised nation of to-day combines the three sorts of revenues, those produced by its own activities and those obtained from taxation and from fees. And furthermore, no nation attempts to exist with only one of each of these kinds of revenues. These different forms are combined into a "system" or general scheme, which con-
Taxes of various sorts are combined into the national system.
forms more or less closely to the general ideal of justice which may have been adopted by the nation. To judge of the justice or expediency of any tax it should be studied in its place in the "system." We have already seen the two main theories as to the proper measure of taxation; the one, that taxation should be measured by benefit; the other, that it should be measured by faculty. A perfect system would so combine the different forms that the total burden imposed would be in accord with the ideal adopted.

There is a constant tendency toward the simplification of tax systems, although most modern systems are still extremely complicated. It is the dream of financial theorists, and has been ever since the science began, and it is the aim of many would-be reformers, to find a single tax that will furnish all the necessary funds for the support of the government. The physiocratic *impôt unique* on the *produit net* is well known, as is also the justification therefor. It is also well known wherein this fails. Modern proposals generally involve something more than mere tax reform. The socialistic demand for a single, exclusive income tax with a progressive rate is advanced with a hope of effecting a redistribution of the wealth of the world. Henry George's well-known scheme for a single tax on land has a similar ulterior purpose. His object is to free industry from trammels which he supposes are due to the appropriation of land values by private individuals. In form his proposition is not very unlike that of the Physiocrats. He is an extreme individualist, but he aims, like the socialists, at a new distribution of property. Of these two modern schemes for a single tax the first is perfectly feasible from the fiscal point of view. Such a tax could probably be administered and could be made to yield ample revenue. It fails, however, to answer the simplest requirements of justice. For example, it would not, unless our whole scheme of economic life were first

altered, seem just that the man whose property was benefited by the grading and metalling of a street should be entirely free from a special charge for the special benefit. The scheme is inexpedient for three reasons : *The socialistic income tax feasible but unjust.*

(1) it presupposes for its successful administration a method of distribution of wealth very different from that which the world now has ; (2) it demands a perfection in the technique of administration as yet absolutely unattainable ; (3) it would need, in order to be fairly administered, more honesty than men have yet shown in their dealings with the government. None of these reasons militate in the least against the incorporation of an income tax in the tax system, beside other taxes. They apply only to its use as the sole source of revenue.

Mr. Louis F. Post, official lecturer for the Single-tax League, gives the following explanation of the second most prominent form of a single tax.

“The practical form in which Henry George puts the idea of appropriating economic rent to the common use is ‘*To abolish all taxation save that upon land values.*’ This is now generally known as ‘the single tax.’ Under its operation all classes of workers, whether manufacturers, merchants, bankers, professional men, clerks, mechanics, farmers, farm-hands, or other working classes, would, *as such,* be wholly exempt. It is only as men who own land that they would be taxed, the tax of each being in proportion, not to the area,

Henry George's single tax defined.

but to the value of his land. And no one would be compelled to pay a higher tax than others if his land were improved or used while theirs was not, nor if his were better improved or better used than theirs. The value of its improvements would not be considered in estimating the value of a holding; site value alone would govern. If the site rose in the market, the tax would proportionately increase; if that fell, the tax would proportionately diminish."¹

A full discussion of the economic and social effects of Henry George's single tax would carry us far beyond the scope of this book. The argument for the single tax, as a mode of taxation alone, is far from complete by itself. In so far as it can be stated

The argument for the single tax. separately it has been well given by Fillebrown.² His statement is as follows:

"a. The site value of land is a social product. b. A land tax cannot be 'shifted.' c. The selling value of the land is an untaxed value." From *a* he would have us draw the conclusion that the ground rent should belong to the community as a whole. This, of course, involves the economic argument for the single tax. From *b* he would have us infer that the only person affected would be the landlord, and from *c* that "if all taxes are ultimately taken from rent, it follows that in the course of two or three generations taxation may cease en-

¹ "The Single Tax," p. 1. Henry George, *Progress and Poverty*, Bk. VIII., Chap. II.

² *A. B. C. of Taxation*, p. 155.

tirely from being a burden upon any one.”¹ In the first edition of this book there was a discussion of the probable sufficiency of the revenues which could be obtained from this source, and figures were presented from which the author was inclined to draw the conclusion that the entire ground-rent would in most communities be less than the revenues now being spent by the government. Those figures have been questioned, and it is difficult, if not impossible, to get any that both sides to the controversy would be willing to accept. But it appears to the author on more mature consideration that the point is not quite pertinent. Because, if it were admitted on the one hand that all taxes other than those on land values were unjust, then it would become the duty of the government to keep its expenditures within the revenues available. But on the other hand some of the ablest among the modern disciples of Henry George do not lay full stress on the word “single.” “It is a question of applying land values to the common use as far as they will go, or as much of them as may be needed, as the case may prove to be.”²

Aside from any question as to the probable sufficiency or insufficiency of the revenues, the single tax presents a great many practical administrative difficulties for the solution of which no detailed

¹ *Op. cit.*, p. 163.

² Louis F. Post, *The Single Tax*, p. 86. Quoted approvingly by Fillebrown, *op. cit.*, p. 154.

suggestions have been offered. Thus we cannot easily foresee how, under the changed conditions, the assessment would be made, or how the actual ground-rent would be ascertained. It is especially difficult to see how the revenues would be apportioned among the various divisions of government, or what would be the assignment of governmental functions to different divisions of government under the new régime. All these difficulties make governments hesitate to plunge into so comprehensive a change, the outcome of which it is so difficult to foresee.

If on economic grounds, or on the ground of general public policy, we deny that any such fundamental changes in the modern system of land ownership, possession, or enjoyment are desirable, or that the "private appropriation of ground-rent" is in any way a wrong, or the cause of any social or economic evils, then the case against the single tax is clear. It would be fundamentally unjust because it lays an unduly heavy burden on certain classes and allows others to go free or at least to enjoy a very considerable abatement in their contributions to the common ends of society.

An apparent application of the single-tax idea is found in the recent extension of a system of special taxes on the increment of land values, especially in large cities in Germany. As these cities have grown rapidly

Difficulty of administering the single tax.

Economic objection to the single tax.

Modern taxes on the increment of land values.

in population there has come a corresponding increase in land values. In many cases the existing tax systems have been insufficient to reach this added tax-paying capacity in a manner that seemed adequate under the new conditions, and consequently new special methods of reaching it have been devised. The special taxes are usually based on the so-called "unearned" increment in value and not on any increase due to actual outlay or improvements made by the owner. They are usually levied at the time of a transfer, when the actual increment of value appears. The rates, while often sharply progressive according to the percentage of unearned increment over cost, are not so heavy as to take the entire increment. They accrue, as a rule, to the benefit of the cities only. These taxes are therefore unlike the "single tax" in that they do not in any event take the whole of the ground-rent, whether as an annual payment or in capitalised form.

Every tax tends to repress the development of the particular phenomenon on which it rests. A single tax of any kind will tend to defeat its own ends by repressing the existence of the phenomenon which gives the signal for its assessment. For example, in Mexico land is not taxed, but if the farmer kills a cow, or sells a crop, he is taxed. Naturally this discourages any extension of the uses of land that involve this disagreeable consequence. The experience of nations which has led them to

*A single tax
would defeat
its own ends
by repressing
the thing upon
which based.*

diversify the forms of their taxation is, therefore, supported by theoretical considerations. The tax system of the United States is still, and the tax systems of all European nations have been, until recently, and are yet in great measure, mere accidental jumbles of different historical taxes, which are retained simply for the revenue that they yield and not because of any belief in their justice. It is not often that nations are rich enough to enjoy what Professor Cohn has well called the "luxury of reform for reform's sake." Their reforms have been most often undertaken for the sake of increased revenues.

To be sure, the rough edges have been somewhat worn away by the friction of economic forces, and the process of tax shifting has in some instances removed some of the worst injustices. But examined from the standpoint of some ideal system, the tax systems of many modern nations fail woefully. It matters little which ideal be the one held up by which to test them; whether it be that of the benefit theory, or that of the faculty theory, the failure is the same.

SEC. 2. What in the opinion of nations constitutes the ideal of correct or just taxation? The answer to this question is to be sought in the theories of taxation that have found favour, and are generally contained in the writings of economists and financiers. The Physiocratic answer was, we have seen, inadequate. The benefit theory

would say that each citizen should pay according to the benefit he receives. What is the benefit and how is it measured? The common benefits are, clearly, the peaceful enjoyment of life, liberty, and property. The protection the State affords to life and liberty is theoretically equal for all; that to property might be considered to vary as the amount of property varies.¹ A uniform tax on each poll for the first two benefits, and a proportional tax on property, would seem to answer the requirements of this theory with sufficient accuracy. But the relatively small returns from the poll taxes and the great expense and friction of collecting them soon led to their partial abandonment. Property then remained the chief basis under this theory. The value of property seemed clearly to depend on its revenue-yielding power. It is a matter of comparative indifference which is taken. Hence the idea embodied in the famous dictum of Adam Smith: "The subjects of every State ought to contribute toward the support of the government, as nearly as possible, . . . in proportion to the revenues which they respectively enjoy under the protection of the State."² But here again as the industrial population separated from the soil and a large body of citizens arose, who had no

¹ The benefit theory has been illogically developed into a defence of progressive taxation. See Seligman, *Progressive Taxation*, 2d ed., p. 181 ff. I have not included this illogical side in the discussion.

² Bk. V., Chap. II., Part II. On the various interpretations of this passage, see Seligman, *op. cit.*, p. 150.

land and little personal property, and who could ill afford to part with any of their earnings, humanity and expediency urged the exemption of the minimum of subsistence. It cost too much and caused too much bitterness to collect taxes upon those having only the bare necessities.

Then came Ricardo's suggestion, "The power of paying taxes is in proportion to the net, and not in proportion to the gross revenue." The items that were to be deducted were the costs of production, among which were then counted the bread and meat for the labourers, which were regarded very much as so much fuel shovelled into the furnace of a human machine. Hence it was argued that it would be too burdensome to production to tax what was necessary to maintain the productive power of the workers. A certain amount of income, therefore, should be exempt; for if taxed, the tax would certainly be shifted. Fortunately, according to the prevalent theory of wages, the amount to be exempted would remain fixed, or nearly so, advancing, if at all, very slowly. So that all incomes over a fixed amount were to be taxed proportionally, since the benefit to such individuals as possessed incomes above the chosen minimum was supposed to be in exact proportion to the amount in excess of the minimum. Stated broadly, this theory was as follows: All taxes must be proportioned to benefit. Certain classes only are benefited, namely, those having income over a certain amount; that is, over

the minimum of subsistence. They should be taxed on the amount above that minimum of subsistence. It would seem, then, that the money spent in protection of the workers who lived on the minimum of subsistence was to be treated as if of benefit to the other classes. This puts the worker in much the same category with the pauper for whom the State, from reasons of humanity, decides that it is worth while to care. With a clearer perception of the character of production and a realisation of the fact that the worker was a man, the satisfaction of whose wants, even if they did not exceed the minimum of subsistence, was yet as important as the satisfaction of the higher wants of other classes, came a realisation of the inadequacy of this theory. It is now quite generally abandoned, except as the legal theory in America.

Perhaps the best statement of the United States legal theory of what constitutes the just measure of taxation is given by Judge Cooley.¹

"If it were practicable to do so, the taxes levied by the government ought to be apportioned among the people according to the benefit which each receives from the protection the government affords him; but this is manifestly impossible. The value of life, liberty, and of the social and family rights and privileges cannot be measured by any pecuniary standard; and by the general consent of civilised nations, income or the sources

¹ *Taxation*, p. 24.

of income are almost universally made the basis upon which the ordinary taxes are estimated. This is upon the assumption, never wholly true in point of fact, but sufficiently near the truth for the practical operations of government, that the benefit received from the government bears some proportion to the property held, or the revenue enjoyed under its protection; and though this can never be arrived at with accuracy, through the operation of any general rule, and would not be wholly just if it could be, experience has given us no better standard, and it is applied in a great variety of forms, and with more or less approximation to justice and equality. But, as before stated, other considerations are always admissible; what is aimed at is, not taxes strictly just, but such taxes as will best subserve the general welfare of political society."

Benefit as a measure of taxation is therefore according to the admission of one of its strongest advocates inadequate. Only in special instances can benefit be directly measured. There, of course, it has been and will remain the basis of taxation, at least until the State shall decide that the special benefit has been merged in the common benefit.

SEC. 3. But the faculty theory, while offering some difficulties, is on the whole more satisfactory. The faculty theory is well illustrated by the history of the English poor law, to which reference has already been made. At first the attempt was made to supply

The faculty theory illustrated by the English poor law.

the wants of the poor by voluntary contributions. But it soon became apparent that all were not contributing "as God had prospered them." The idea that the support of the poor was a benefit to the other classes, except, perhaps, so far as almsgiving was supposed to insure a man's salvation, did not appeal to the legislators. They anxiously avoided making the contribution compulsory because it would be hard to justify such a policy by pointing to any benefit. But they felt that fairness demanded that each should contribute according to his ability. Indeed, this was their understanding of the Divine command upon which they were consciously acting. The justices of peace were, without any very definite instructions as to the mode of procedure, authorised to see that each person contributed fairly according to his ability.¹

What then constitutes ability? The original idea seems to have been that the possession of property constituted ability. But the value of *Original idea* property depends upon its power to yield *of faculty.* the owner a revenue. If we consider landed property only, we find historically the greatest uncertainty as to whether men should be assessed according to some estimate of the salable value or according to its annual yield. This uncertainty arose *The salable value or the annual produce.* from the conditions of the times. The salable value of landed property was, of course, determined by the annual produce or revenue-

¹ Ashley, *Economic History*, II., p. 380.

yielding power. In the middle ages land was not salable property; hence, it was the custom to value it for purposes of taxation according to the annual produce, or the annual rental value, which was determined by the produce. The history of taxation in the American colonies is very instructive as to the method of determining what constitutes faculty or ability to pay. Here for the first time in history, or at least since the fall of Rome, was a country that enjoyed almost absolute free trade in land. When the Connecticut proprietors bought in fee simple lands in Vermont, which they had never seen, to be sold again on the same terms to settlers, whom they had never seen, often for prices which the same lands

Free trade in land in New England. would not bring to-day, they were doing what was not possible in any European country at the time and what is only partly

possible in most of them to-day, *i.e.* selling land as one sells wheat or any other commodity. The New England colonists, therefore, had the choice of two methods of assessing property in land: they could follow the older method to which they were accustomed at home, which assessed the rental value of the property, or they could take some method suggested by the fact that lands were really sold, in fee simple, for a price. In general they chose the latter, although there are numerous traces of the old method both in the tax laws and in other regulations that are of a similar character. It is unfortunate that none of the investigations into the history of this period have

been specially directed toward this point. Vermont furnishes one of the best examples of the principles underlying the colonial ideas of taxation.¹ There the conditions were very simple. Taxation was intended to cover all male inhabitants. Every male between 16 and 60 years of age, with a few definite exceptions, was "rated" at £6 on his person. That is, everybody was considered to be able to contribute something, whether he had property or not. Then the different items of property were "set in the list" over against the name of the owner at fixed rates. For example, each acre of improved land, 10s. ; an ox or steer four years old, £4 ; three years old, £3 ; two years old, £2 ; one year old, £1 ; a horse three years old or over, £3 ; all "horse kind" two years old, £2. Money on hand, or due, was listed at £6 in the £100. Then all persons were listed "for their faculty," according to occupation and earnings : attorneys at from £50 upwards, as the value of their practice increased ; all tradesmen, traders, and artificers "proportionally to their gains and returns." Other items of property were entered in the list in a similar way at fixed rates. The sum total of all the different items over against the name of each person was supposed to represent his total ability or faculty. The notable thing about all this is that only revenue-yielding property was listed. It was not a property

¹ Wood, *History of Taxation in Vermont*. Columbia College Studies, IV., 3.

tax purely, nor an income tax. But the thing which it sought to ascertain was how much ability or faculty each person had. All property that was regarded as indicative of faculty was listed, and many other things that were also indicative of faculty were included. Later, however, Vermont adopted a form more nearly in accord with the idea that property alone indicates faculty.

There are, then, two ways of ascertaining faculty. In the one the base is primarily the property irre-
Faculty measured by property or by income. spective of the revenue the property yields. In the other it is income from property or from other sources. There

are also two ways of completing the measurement: We may assume that faculty is proportional to property or income; that is, that it increases in exactly the same ratio as property and income increase. Or we may assume that it increases more rapidly than either property or income. The choice of base and the choice of rate have given rise to long and weary discussions and hair-splitting distinctions. In regard to the first, it is sufficient to say that at present the most widely accepted view is that, from the standpoint of abstract justice, income forms a better starting-point for the deter-

Faculty increases more rapidly than property or income.

mination of faculty than property. But we cannot avoid entering the discussion as to whether faculty is in proportion to income or increases more rapidly. The widespread advance of democracy, and of sympathy

for those in the lower walks of life, led to the desire to justify if possible the exemption of smaller incomes, especially the minimum of subsistence, and this desire found means of fulfilment in the newer theories of value, the conception of marginal utility, and the discussion as to the relative urgency of different wants. If we classify certain wants as absolute necessities, then the conclusion is near that the possessor of the minimum of subsistence has no ability to pay taxes. The possessor of a great deal more than the minimum of subsistence can in proportion bear more taxes than one who has only enough to obtain a few comforts in addition to the necessities. That is, the test of justice is found in equality of sacrifice, and we impose a greater sacrifice if we take away from the labouring man with \$1500 a year 10 per cent of his income than we impose on the capitalist with \$15,000 annual income by taxing him in the same proportion. Moreover, if we look upon faculty as identical with general economic power, then it is clear that, as the control of wealth increases, the ease of further increase is greater. Thus it is easier relatively for the millionaire to double his fortune than it is for the daily wage-earner to rise to independence.

Only slightly different in form is the so-called "leave-them-as-you-find-them" theory of justice in taxation. That is, that taxes should be so imposed that when all have paid them, each will be left in

the same position, relative to his fellows, as he was before the payment.¹

SEC. 4. There are two other theories, which, independent of the idea of sacrifice or of increased economic power, attempt to justify a higher rate of taxation for higher incomes than for lower. These two theories adopt the hypothesis that the common benefit is equal, and demand that the inequalities in wealth should be removed in order to make it easily possible to tax according to this equal benefit. There are, first, those who argue that the inequalities in wealth are due in large measure to the action of the State, and hence the State is justified in abandoning the idea of equality of a taxation and in taxing those who have much wealth more heavily than others, for they have gained from the State's own action. This has been called the compensatory theory. Others, again, starting from the same hypothesis, urge that taxation cannot be equal, because evil economic forces have changed the abilities of the taxpayers and that it is the duty of the State to offset these forces by readjusting wealth through taxation. This has been called the socialistic theory. Neither of these theories can justly be called scientific; they both cut loose entirely from existing conditions.

¹ The student will do well to read carefully the three essays by Edgeworth on the "Pure Theory of Taxation" in the 1897 volume of the *Economic Journal*.

We cannot, within the limits of this work, attempt an exhaustive criticism of all the different theories as to justice in taxation. But the conclusions reached by Seligman after an exhaustive study of all the different theories are too *Seligman's conclusions as to progression.* important to be omitted.¹ He finds the benefit theory, like the socialistic and compensatory theories, wholly inadequate. But the faculty theory is satisfactory and seems to him to justify a moderate progression. Greater faculty is represented by the higher income: (1) because, after the initial disadvantages have been overcome, it is easier to acquire more; (2) because the sacrifice of the same proportion of the larger income is less than in the smaller income. Neither of these reasons suggests a definite rate of progression. He says: "If, therefore, we sum up the whole discussion, we see that while progressive taxation is to a certain extent defensible as an ideal, and as the expression of the theoretical demand for the shaping of taxes to the test of individual faculty, it is a matter of considerable difficulty to decide how far or in what manner the principle ought to be actually carried out in practice."

It would seem, then, that, in general, faculty is the ideal base of taxation; that faculty can be measured either by property or by income, but best by the latter; that faculty increases somewhat progressively and is affected by the consideration of relative con-

¹ *Progressive Taxation*, 2d ed., p. 302 ff.

ditions, as the kind of property, the source of the income, or the burdens already resting upon the individual or property. All these considerations have to be applied in determining whether the tax system of any country complies with the rules of justice. They do not apply with the same strictness to the separate taxes.¹

Modifying relative conditions.

¹ The recognition of the principle of progression in the recent reforms of taxation is very marked. See Seligman, *Essays*, 305 ff.

CHAPTER IV

THE DEVELOPMENT OF TAXATION BEFORE THE INDUSTRIAL REVOLUTION

SECTION 1. Feudalism placed a large number of economic receipts directly in the hands of the rulers. These receipts were generally sufficient for the discharge of the customary public activities. It is a mistake, therefore, *Taxes not found under feudalism.* to search for taxes proper in the period of the supremacy of feudalism ; that is, from the capitulary of Charles the Bald, 877, to the end of the thirteenth century. Taxes begin to emerge with the transformation of feudal rights and dues, the commutation of obligatory military services, and the like into payments in kind or in money. Greek and Roman forms of taxation had even less influence on modern systems of taxation than Greek and Roman forms of expenditure on modern spending. For the study of Roman law and the traditions of the glory of the Roman Empire determined many State activities that involved the spending of public wealth. But new methods of obtaining the funds were devised. Information concerning the taxes of the period from the fall of Rome to the capitulary of Charles the Bald is rather meagre and too vague to be of much value.

The first taxes to emerge from the darkness of this period are a number of fee-like contributions of *Early taxes* the nature of commuted feudal services, *were com-* or directly connected with feudal rights, *muted feudal* certain market dues and customs duties, *dues.* tolls for protection to travellers, for the use of roads, bridges, and ferries, and two forms of property taxes, land taxes and family taxes. The land taxes of this period are just emerging from the character of rent payments and acquire only by degrees the characteristics of pure taxes. Even in the case of land left to the original possessors after conquest, the payments demanded are more of the character of rents than of taxes. But the combination of these charges with hearth or family taxes leads to the formation of a sort of mixed property and personal taxes. The fact that land is practically the only kind of revenue-yielding property and that no considerable earnings are made without the use of land makes this tax sufficiently universal for the demands of justice.

Direct taxes are in this period, as in classical times, never paid by the freeman. They are regarded as *The freeman* derogatory and as the badge of a servile *exempt.* position. The freeman could give his services to the State, he could risk his life for it, but he would regard it as a deadly insult if he were asked to pay taxes. Indirectly, of course, he was taxed, as, for example, when he bought merchandise, for permission to sell which the trader was taxed.

As soon, however, as industry began to develop,

as soon as the crafts sprang up in the cities which clustered around the market-places, and classes which had lived in part from industrial pursuits found it possible to obtain so wide a market that they could live entirely from their industry, then, there arose such a differentiation of the sources of wealth that the old forms of taxation were insufficient. Taxation had, therefore, to be extended to meet the new forms of wealth. The first methods of taxing these were dictated solely by expediency and the desire of obtaining as large revenues as possible, rather than by any definite ideas of justice, and were mainly indirect in character and partly an extension of the older market dues, excises, customs, and tolls, together with new taxes of the same kind.

Of old Roman taxes none can be strictly said to have survived the conquest. Some lasted throughout the Merovingian period in a greatly changed form. Finally they were merged into various feudal payments, and took on the nature of rents. A few relatively insignificant market dues and fees constitute the only taxes which regularly formed a part of the revenues of the State or of the State's officers, the feudal lords. The regular feudal burdens, while economic in character and not fiscal, really fill the place of the later direct taxes. In proportion to the prosperity of the people they were certainly as heavy as any modern systems of taxes. The rapid disintegration of the German

Taxation extended to meet new forms of wealth.

Feudal dues form a burden as heavy as taxes.

Empire into smaller territorial lordships after the sixteenth and seventeenth centuries rendered the question of imperial taxation at once less pressing and more complicated. On some eleven different occasions, according to Wagner, between 1427 and 1550 the Empire as such stood in need of extra revenues, for purposes so clearly of common benefit as to justify a demand for common contributions. Such an instance is that of the Hussite and Turkish wars. The tax used was the "common penny." This direct imperial tax was a mixture of poll and personal taxes with income and property taxes. We find very similar taxes in France and England. It fell upon all imperial subjects whether holding from the crown or not, provided they held property. The rate was an irregular regressive one, being smaller for all above a certain amount of property. It was very badly administered and not universally collected.¹

In the German principalities that were formed out of the German Empire the first direct taxes were the *bedes*. These were extra payments, similar in form to the existing feudal contributions. They were made by those already paying such dues and were measured in somewhat similar ways. The basis was generally landed property. The first *bedes* were more or less voluntary, private contributions for the support of the *Vogt*, count, or lord for some recognised public purpose. By con-

¹ Cf. Wagner, Schönberg's *Handbuch*, 3d ed., III., 184.

tracts entered into between the contributors and the lords, they became compulsory and formed part of the regular income of the lords, who then in extraordinary cases of need would again come forward with the demand for extra or "necessity" *bedes*. This was frequently done in times of war. Hence, these *bedes* were often called "army *bedes*." Some of these in turn became customary or fixed. With the rise of the idea of public life and public needs, the *bedes* easily became compulsory public contributions, and were regarded as distinct from the feudal dues, which by virtue of longer standing and the absence of a recognised public purpose were treated as the private revenues of the prince. A peculiarity of the earlier assessments of the *bedes* was the method of apportionment to, or assumption by, the different orders or cities of a certain lump sum, which was then distributed by their own rulers among the different members, according to some measure agreed "Donative upon. Prelates, clergy, and knights were *monies*." exempt from the ordinary *bedes*. They sometimes rendered similar contributions, hedging themselves in with all sorts of reserves and precautions, to prevent the payments becoming regular. These were called "donative monies."

It was in the cities that retained a large degree of political independence that the highest development of the fiscal system was to be found in the middle ages. This is owing to the fact that they were in advance of the rest of the country in their economic de-

velopment. Long before the principalities were able to abandon payments in kind and services, the cities were collecting taxes in money, making some use of public credit and developing regular fiscal offices. "The art of taxation," says Wagner,¹ "the use of public credit, and the practical organisation of the financial administration in the cities had been an important part of public institutions for centuries before the territorial State had even recognised the need of such." This field has, however, not yet received the attention of historical investigators sufficiently to allow us to draw conclusions as to the generally prevailing forms.²

SEC. 2. In France the early growth of a strong central power led to an intensification and sharp differentiation of the royal feudal dues from the other feudal charges, which gives them something the character of taxes. But inasmuch as the French State was peculiarly a proprietary State, and the territory was rather a part of the private property of the king than public property in the modern sense, these early charges are not taxes proper, but rents, or, to use the more general term, feudal dues. But the rapid growth of the central power, and the high development of public needs in the kingdom, necessitated more revenues. These needs were at first

Royal feudal dues in France not properly taxes.

¹ Schönberg's *Handbuch*, 3d ed., III., 185.

² See Schönberg's *Investigations into the City of Basel*.

met by the collection of indirect consumption and trade taxes. The tendency toward the development of indirect taxes grew apace after the seventeenth century. The mercantile theory, which was supreme for most of the time after Colbert, prompted a high development of custom duties, and these ran parallel with internal consumption taxes. In the eighteenth century there were three, or possibly four, important taxes which had grown up in various ways out of the feudal dues. These were the "*taille*"¹ (tallage), the "*vingtièmes*" (twentieths), the "*capitation*" (poll), and possibly the "*dîmes*" (tithes).²

The *taille* is of feudal origin. Originally it was arbitrarily assessed with extreme rigour upon the serfs by the lords, and occasionally upon the great vassals by the king with the assent of the peers. It became a permanent charge when royal power was firmly established on the ruins of feudalism. Charles VIII. made it permanent at the same time with the

¹ The term "*taille*," in English, tallage, also spelled *talliage*, *tailage*, and *tailiage*, is from a root meaning "to cut." It is explained as derived from the general method of keeping accounts by means of notched sticks. A *taille* was any sum of which account was kept, then the amount scored up (tallied) against any person. Slender sticks with notches called "tally-sticks" were used by the English exchequer for accounts, until abolished by the statute of 23 Geo. III., c. 82. Similarly, the German *Kerbe*, tally sticks. Other roots meaning "to cut" are common in the names of various taxes; viz. *incisio*, *incisura*, *cise*, later *accise*, *adcisio*, Eng. excise; in these Latin roots the thought is, that a part of the taxed article is cut out for the government.

See Vignes, Ed., *Traité des Impôts en France*, 1872, p. 10.

establishment of the royal army. The *taille* was both real and personal. On the one side
The taille. it was based on the revenue from landed property ; on the other, it was based on the faculty of the taxpayer, measured by the revenues from his landed property, and active rents, as well as the products of his own industry. This tax, suppressed in 1790, yielded 44,737,800 livres the year before. Necker obtained 91,000,000 livres from it. Nobles and clergy were exempt.

The *vingtièmes* consisted of one or more twentieth parts of the revenues from either landed or movable property. This tax had a varied history. At first it was used with the *taille*, but when that tax was
The ving- made permanent under Charles VIII.,
tièmes. the *vingtième* disappeared. It was revived in 1710 by Louis XIV. as a war tax. It remained as the occasional resource of the treasury up to the Revolution. Only the clergy were exempt. It produced 46,000,000 livres (under Necker, 55,000,000).

The *capitation*, or system of poll taxes, was the variable tax of the ancient monarchy. It dates
The capita- from 1695. It was first regarded as a
tion. temporary expedient, but was continued to the Revolution. It was assessed according to a tariff of twenty-two classes. But the base was frequently changed. The clergy were exempt, the nobles were taxed on the basis of their presumptive ability, and those who paid the *taille* were

taxed according to the amount of that tax they paid. In 1786 it yielded 41,500,000 livres.¹

The *dîme*, or tithe, was an assessment paid in kind from the fruits of the soil for the benefit of the clergy. The tax was not always the *The dîme.* tenth, but varied from one-seventh to one thirty-second. The ecclesiastical purpose of this payment has led some to refuse to call it a tax in the strict sense. Since the Church exercised a power that differed little from that of the State and the burden was a regular one maintained for a public purpose, it should probably be called a tax.

The *corvées* were more strictly taxes than the *dîmes*. These were personal services applied to the construction of the roads and other public works. They were regarded as feudal dues. *The corvées.* They were of two kinds: the first were levied on property and rendered by the proprietor for his lands, and the second were levied on persons and rendered by all, irrespective of land-holding. The nobles and the aliens were not subject to the personal *corvées*. The clergy could commute them into money payments or have them rendered at their own cost. The land *corvées* were due from all hereditary proprietors irrespective of rank, but they were not bound to furnish them in person. Louis XVI. suppressed the *corvées* in 1776, but they were reëstablished. They disappeared in 1793.

The most important indirect consumption taxes

¹ For further details see Parieu, *Traité de Impôts*, I., p. 144 ff.

were leased for 166,000,000 livres, and those collected by the government were 51,500,000 livres. These together nearly equalled the revenue from direct taxes. The indirect taxes of the ancient monarchy were : first, the *aides*, which consisted of taxes on drinks, on articles of gold and silver, on iron, oil, skins, starch, bills, paper, etc., and the *octrois*, levied at the city gates on all sorts of goods when brought into the towns ; second, the *gabelle*, or salt tax, which was so arranged as to amount practically to a direct tax. For the people were obliged to buy each year from the management of the monopoly an amount of salt determined in each case by the size of the family. There was a similar "salt conscription" in Germany. Thirdly, there was the tax on tobacco.

SEC. 3. In England¹ we find in Anglo-Saxon times three principal taxes : (1) The ship-geld, or *Early English ship money*, a tax imposed on those *taxes.* shires and towns along the sea-coast which were unable at time of need to furnish ships for defence, when invasion was threatened. It was levied intermittently and was used exclusively for naval purposes. The attempt of Charles I., in 1637, to impose this tax on all of England and for purposes other than the navy, was one of the contributing causes of the civil war. (2) The tribute-like "Danegeld" was levied after 991 at so much a hide (piece of land) and paid to the Danes to prevent

¹ See Dowell, *History of Taxation and Taxes in England*.

them from raiding the coasts. After the cessation of the original cause, it was collected by the kings as private revenue. (3) The "funage," or "tax of smoke farthings," was a tax on every hearth. This seems to have been a traditional form of tax with the Saxons. It was in effect a family tax, as the hearth stood for the family.

In Norman times, the feudal character of the government was such that it obtained revenues from the demesne, from feudal dues, and from the royal prerogatives so great that no real taxes exist. The Danegeld was levied by the Conqueror as an annual tax, but disappeared after 1163.

With the reign of Henry II. came a more ordered and regular system of taxation. This began with the well-known commutation of the military obligations of tenants. It was due to the continental position of the Angevin kings. The distance at which war was waged and the length of service demanded rendered the military obligations particularly burdensome, and tenants were anxious to commute them. An army of mercenaries, too, suited the king better, as easier to control than the feudal army. Hence arose the commutation of the duty to foreign service into a money payment of two marks, £1 6s. 8d., on each fee of £20, known as the "scutage," or shield-money. Henry II. collected three such scutages, and this tax did not fall into disuse until after 1322. It was practically a land tax, levied each time for a special purpose.

*Commutation
of military
services.*

The tallage in England was the tax that was collected from the tenants on the royal demesne on occasions of unusual expense. Those *The tallage.* who paid the hidage or Danegeld were generally exempt. Cities and towns not exempt in this way paid the auxilium or aid. The tenants were liable for these taxes up to one-tenth of their goods. In the city of London the tallage was treated as a "benevolence." It was superseded after Edward III. by the general taxes on movables.

The taxes on movables began with the "Saladin tithe" in 1188.¹ It was one-tenth of rent and movables paid by all except crusaders. Out *The beginning of taxes on movables.* of this insignificant beginning grew a system of taxes on movables which finally included all the taxes so far mentioned. Richard I. levied a tax on all ploughed land in 1194, known as the "carucage," from the area upon which it was levied; namely, the amount of land that could be covered by one plough (*caruca*) in a season. After 1224, this was merged in the tax on movables.

The tax on rents and movables, which began, as just *The "thirteenth and fifteenth."* stated, with the Saladin tithe, was continued from 1189 to 1334. This was a grant of one-thirteenth in 1207, one-fifteenth in 1225, one-fortieth in 1232, one-thirtieth in 1237,

¹ The tithe, or tenth, as the rate of taxation appears in many taxes in Christian countries. It is especially common in Catholic countries. The idea of taking a tenth has its origin in Mosaic law: "And concerning the tithe of the herd, or of the flock, *even* of what-

one-fifteenth in 1275. Up to 1283, the method of obtaining the grant was by separate negotiations with each section of the country. But after that date, general grants were made by Parliament and other taxes were discontinued.

Besides these direct taxes, the crown had the privilege of taking "customary" tolls upon merchandise imported or exported. Hence our *Customs* modern term, "customs duties." These *duties*. tolls were of the character of licenses and protection money. Their early history is obscure. Before the Magna Charta they had become so fixed and regular as to call forth the well-known clause of that historical document: "Let all merchants have safety and security to go out of England, to come into England, and to remain in and go about through England, as well by land as by water, for the purpose of buying and selling, without the payment of any evil or unjust tolls, on the payment of the ancient and just customs" (*sine omnibus malis tollis, per antiquas et rectas consuetudines*). In 1275 these "ancient customs," slightly raised, were granted Edward I. by Parliament. The chief duties were on wine imported and wool exported and a poundage on all other imported goods or exported.

From 1334 to 1453 there are a number of changes to note. The fifteenths and tenths were appor-

soever passeth under the rod, the tenth shall be holy unto the Lord." Lev. 28 : 32. A half a tithe and other convenient fractions give rise to the rates, which otherwise appear irregular.

tioned among the communities, cities, and boroughs, the townships and the demesne tenants, in 1334, and the assessment then made remained the basis of taxation. The tax thus became a fixed charge. It varied in rate from one-half a fifteenth and tenth, to two-fifteenths and tenths, as the need for revenues changed. Sometimes no such grant was made. In 1377 Parliament granted to the king a tax of "four pence, to be taken from the goods of each person in the kingdom, men and women, over the age of fourteen years, except only real beggars." This was known as the "tallage of groats." Subsequently a classified poll tax was employed, in which an attempt was made, by the arrangement of the payers into classes and a gradation of the rates, to get a larger return by taking advantage of the greater wealth of certain classes. The rates were: for the Duke of Lancaster, who was the highest subject, £6. 13s. 4d.; earls £4, barons £2, and so on down to the lowest; every one, except beggars, was to pay at least a groat or 4d. In 1379 this yielded £25,000, which was only slightly more than the previous tallage of groats. The clergy were included in both these taxes. After the peasant revolt, which was occasioned partly by the oppressive methods used in collecting these taxes, return was made to the fifteenths and tenths. From 1382 the landowners take the whole burden of the old "fifteenth and tenth." In 1435 this was supplemented by a graduated tax on in-

come from lands, rents, and annuities, and offices of freehold. In the reign of Edward III. the customs yielded large returns. They consisted as before of tunnage on wine, customs on wool and leather, and poundage on all other merchandise. The popularity of Edward IV. enabled him to add to his other sources of revenue the "benevolences," demands on the rich for special contributions. "Benevolences." These "benevolences" were not always cheerfully paid. It was more often "as though," says More, "the name of *benevolence* had signified that every man should pay not what he himself of his good will list to grant, but what the King of his good will list to take." Throughout the history of taxation in England the grant of monopolies of new industries was made a source of income to the government. The multiplication of these under Elizabeth did not yield much revenue, although it gave rise to much discontent.

There is little in the varied application of these taxes that is important as showing the line of development until the seventeenth century. At that time they proved unequal to the task of meeting the growing needs of the treasury. The chief auxiliary lay in the extension of the indirect consumption taxes. The year 1692 (revision, 1697) saw the establishment of a permanent land tax. This grew out of the apportionment of the "fifteenths and tenths." It became a fixed charge on land, a real burden, not having, as time

The permanent land tax.

went on, any definite relation to the income from land. In 1798 Pitt made this redeemable by the payment of a lump sum down, after which no annual tax would be collected. This privilege has been taken advantage of to the extent of removing half the charge from the lands. In its operation the land tax became rather a rent than a tax.

The wars of the period of the French Revolution and the consequent need of revenue introduced the *The income tax.* general income tax (1798, 1802, 1803, 1806). This tax was no departure in principle from the older taxes, although a departure in method. It has been well characterised as a combination of several taxes into a system which has for its aim the proportional taxation of all incomes, with the exemption of a certain fixed sum (degressive). The form which it took in 1803 is the best to study. Two separate acts were passed, the one taxing all incomes from holdings of real estate, rents, and public salaries at the source; that is, so far as possible the tax was deducted before the revenues passed into the hands of the recipient. The second taxed industrial earnings and interest on capital on the basis of a declaration by the taxpayer. The tax began with an income of £60 (later £50), and this amount could be deducted from all incomes below £150; after that the full rate was paid. Each person was required to declare his whole income and could claim reimbursement for any tax stopped at the source if he could show that his total income

was below the minimum. This tax, set aside in 1816, was restored in 1842, as a substitute for the indirect taxes, removed in consequence of the demand for commercial freedom. The rate is changed from time to time as the needs of the government change.

SEC. 4. Local taxation in England has been partly independent of royal taxation. England has not followed the continental plan of collecting revenues for local purposes in the form of additions to the national taxes. While the weight of national taxation fell upon customs duties, excises, and certain direct taxes, *The poor rate the prototype of local taxes in England.* measured roughly by income, local taxation was based exclusively upon revenues from real estate. The prototype of all local taxation was the poor rate. Previous to the reign of Elizabeth local activities were of such a character that they could be discharged from feudal dues. In the manorial villages and the boroughs with semi-feudal guild, and close corporation governments, which owned landed property, feudal incomes paid the few public expenses. But the removal of the monasteries, hospitals, and other charitable foundations, threw upon public charity a number of well-developed paupers; and the rapidly changing character of industry and of economic life constantly gave rise to the problem of what to do with the unemployed, who at times became very numerous. The result was the famous poor law of 1601. The principle of the tax for the

support of the poor had been of slow growth. In the reign of Henry VIII. the giving of alms was prohibited, and collections for the impotent poor of the parish were required to be made in each church. In 1547 the Bishops were authorised to prosecute all persons who refused to contribute for this purpose, or should dissuade others from contributing. In the fifth year of Elizabeth the justices of peace were made judges of what constituted a reasonable contribution for this purpose. After 1572 regular compulsory contributions were levied. Out of a purely voluntary contribution, then, there emerged in two-thirds of a century a compulsory tax. The basis of this tax was the annual rental value of real property. The tax was collected not from the owner but from the occupier. Most of the other taxes for local purposes which have developed in England since then are of the same general character. They are too numerous to mention here. Besides the direct taxes, there were a few indirect ones, market dues, road tolls, coal and wine duties.

SEC. 5. In the American colonies we meet with entirely new conditions. Public needs were simple and few, and were mostly local in character. Customs duties were for the most part controlled by the mother country in the interests of her general colonial policy. So the colonists were driven to other forms of taxation. Practically free trade in land existed. Land at a known selling value early formed a large part of

Peculiar conditions in the American colonies.

the property of each citizen, and differed in no essential particular from his other property. There were in some colonies, to be sure, charges of a feudal nature known as quit rents, which were a recognition of the king's interest in the land.

These never became of fiscal importance, *Quit rents.* and never developed into taxes. Nor do they seem to have ever seriously modified the essentially free character of land-owning, since they were so irregularly and meagrely collected. They were "acknowledgments His Majesty receives of the People's Tenure and Subjection."¹ At times they developed into an apparent tax on certain lands. They seldom formed a part of the revenues of the colonial treasuries, being generally payable to the king.²

Just as there were three different forms of government among the colonies, so there were in the beginning three different tendencies in taxation.³ New England began with a *The New England tax on property and faculty.* The General Court of Massachusetts laid down in 1634 the following principle: "In all rates and public charges the towns shall have respect to levy every man according to his estate, and with consideration all other his abilities whatsoever, and not according to

¹ Spottiswood Letters, quoted by Ripley, *Financial History of Virginia*.

² See Wood, *History of Taxation in Vermont*, p. 13. Also Schwab, *History of the New York Property Tax*.

³ Cf. Seligman, *Essays*, p. 19 ff.

the number of his persons."¹ Later, however, poll taxes were used, and the general property tax was extended to cover property in the process of acquisition, or the earnings of labour. In all the New England colonies the resulting system was practically as follows: Each person was to contribute as he was able. Ability was measured, first, by property, real and personal; secondly, by the person himself; thirdly, in the case of wage-earners, merchants, and others, by earnings. With a few notable exceptions, as in the case of lawyers, the third measure of ability gradually fell into disuse. It has been repeatedly pointed out² that the New England people had the habit of saving. All earnings were soon turned into property. So that the demands of justice were fully met by the general property tax and the poll tax. In addition to these direct taxes, there were a number of indirect taxes, "imposts," some collected in the form of licenses, and many as excises.

In the Southern colonies, of which Virginia will serve as a model, the first taxes were the poll taxes. "Personal responsibility," says Ripley, "was thus the basis of taxation at first, but as the burden of taxation became heavier this liability was partly transferred to real estate."³ This transfer of the

¹ Massachusetts Records, quoted by Douglas, *Financial History of Massachusetts*, p. 18.

² Walker, "The Bases of Taxation," *Political Science Quarterly*, Vol. III.

³ *Financial History of Virginia*, p. 21.

burden to real estate began with the practice of making the personal tax a lien upon the property of absentees, or of persons dying before the payment of the tax. The *Virginia poll taxes and customs.*

general property tax in a form like that in use in New England did not exist in Virginia before the Revolution. The grossness of the poll tax was modified by some reference to the different kinds of property owned. In consequence of the failure to develop a good system of direct taxes Virginia resorted to indirect taxes, export duties on tobacco and hides, import duties on liquors and slaves, and some general tunnage duties forming the main features.

The third or central system is fairly represented by New York. There, under the West India Company, 1621-1664, taxation first took the *New York excises.* form of moderate indirect taxes on goods imported and exported and imposts on the consumption of beer, wine, and spirits. It was after the passage of the colony into the hands of the English that attempts were made to develop the property tax. The actual existence of this tax begins with the formation of the Assembly after 1683.¹

In all parts of the United States after the Revolutionary War the main reliance for local revenue was the general property tax. The commonwealths, as such, had little need for revenues until after 1840.

¹ See Schwab, *Die Entwicklung der Vermögensteuer im Staate New York*, Jena, 1890. Also Schwab, *History of the New York Property Tax*, *Pub. of the Amer. Econ. Assn.*, V., 5.

In the formation of the Union indirect taxes were made the prerogative of the federal government, so that the commonwealths had to resort to other means. The character of direct taxation in the United States since the formation of the Union will be treated in the next chapter. The differences in the forms of taxation in the different parts are due both to political and economic differences.

CHAPTER V

THE DEVELOPMENT OF TAX SYSTEMS SINCE THE INDUSTRIAL REVOLUTION

SECTION 1. The trend of the development of taxation was abruptly changed by the industrial revolution at the close of the last century. On the one hand, the development of constitutionalism, vesting, as it did, the control of the purse in the people, and especially in the taxpayers, had the inevitable effect of changing the ideas underlying the tax systems. New ideas as to the justification of taxation developed, and with them a tendency to seek new measures of taxation. On the other hand, the rapid increase in wealth, the growth of new forms of wealth, such as invested capital, the birth of new kinds of property, and of ways of holding property, as the many kinds of credits, and the rapid change in the distribution of wealth among the different classes in the community, — all of these and other similar causes led to the constant extension of taxation to the new forms. Old taxes which were well suited to certain simpler conditions of society become under new conditions unjust, and give rise to dissatisfaction, to many attempted and some accomplished

*Changes in
taxation due
to the indus-
trial revolu-
tion.*

reforms. These reforms in turn prove no more satisfactory in the long run, for the conditions they were intended to meet change again.

Just as the attention of economists was chiefly directed to the study of productive agencies during the first three-quarters of the century, so the general tendency of the same period in finance may be broadly charac-

*Taxation of
the agents of
production.*

terised as an attempt to compel the different agencies of production to contribute to the support of the government. It is claimed that economists have, during recent years, turned their attention more to the consideration of questions of distribution, and it is certainly true that the most recent tax reforms have been in the direction of securing a better division of the burden among the sharers of

*Taxation of
the shares in
distribution.*

the new wealth rather than among the producers thereof. Subordinate to this tendency are various proposals and attempts to alter the distribution of wealth by the use of the taxing power.

The demands upon the revenues increased vastly during and immediately after the period of war which followed the French Revolution. Large debts had been accumulated; great armies and navies claimed support even in times of peace. New functions were being thrust upon the governments. Moreover, the new economic era demanded the payment of all charges upon the State in money and necessitated the col-

*Effect of trans-
ition to a
"money econ-
omy."*

lection of revenues in money. The old feudal receipts and services became more and more inadequate ; new industrial receipts were, in general, not calculated to be much larger than the sums necessary to support the service or institution which furnished them. Consequently, taxation on an ever increasing scale becomes the basis of all State finances. Taxation is no longer regarded as a temporary expedient to meet passing and extraordinary needs. It is admittedly a necessary and permanent policy.

The doctrine of political equality when generally accepted leads to a demand for universality and equality of taxation. The difficulties *Effects of political equality.* that arise are no longer as to the justification of taxation in general, but as to the justice of certain forms and measures of taxation. The main question is, what is equality, and what the best method of attaining it. The methods and direction of reform were necessarily prescribed by the constitutions of the various countries and differ much from land to land. Different economic and social conditions have also an inevitable effect. Among the constitutional features that determine the direction of taxation the following may be mentioned. First, federal governments have generally been excluded from the field of *Federal governments resort to indirect taxes.* direct taxation. The central governments of the German Empire, Switzerland, and the United States depend for revenues

from taxation on customs duties and internal excises. The sense of personal loyalty to the central government is inferior to that to the commonwealth governments so far as willingness to contribute directly to its support is concerned. Those who pay a direct tax wish to see the money expended near at hand and under their own eyes. The partial concealment or at least lack of prominence of the indirect contribution permits of its collection without calling the attention of the contributors forcibly to the fact that they are taxed by a new authority. Just that advantage of partial concealment in this tax which appealed so strongly to the monarchies, before the birth of political consciousness on the part of the people, appeals to the federal governments. At the same time the practical necessity of uniform rates over the whole country, which arises from the fact that these taxes disturb the economic balance of industry and commerce, and the greater ease of administration with a larger territory and a single boundary, make it advisable to put all of them in the hands of the central organ. It was the latter considerations in regard to custom duties that led to the establishment of the Zollverein and eventually of the German Empire.¹

On the other hand, the different States of which the federal governments are composed have shown

¹See Bowring's Report on the Prussian Commercial Union, *Parliamentary Documents*, 1840, Vol. XXI, pp. 1-17. Reprinted in Rand, *Economic History*, p. 170. Also Legoyt's *La France et l'Étranger*, Vol. I., pp. 250-255; *ibid.*

themselves inclined to restrict their taxation to the direct taxes, leaving all but a few of the indirect ones to the central governments.

But this separation of the assessment of direct and indirect taxes between different authorities has been productive of great difficulties. *Difficulties which arise from a division of the taxing power.* For it is impossible to assess any tax justly and equally without reference to the other burdens already imposed on the contributors. It would seem that the demands of justice which dictate that the whole system of taxation should work toward a definite and single purpose, will necessitate either the coördination of these forms or the placing of both of them in the hands of the same authorities. The proper co-ordination of all taxes is hard to accomplish when the taxing power is in different hands. This is one of the hardest problems of American taxation.

The development of direct taxation will now be traced in detail by reference to some of the more important countries. Indirect taxes cannot properly be said to have undergone any process of development. Many changes have, indeed, been made, dictated by different economic theories and purposes. But it has been simply a flux backward and forward. Sometimes ulterior aims, as protection, have been abandoned and strict fiscal principles allowed sway. In those cases we find a simplification and a decrease in the number of articles taxed. But no general principles have been developed.

SEC. 2. Probably the most thorough attempts to reform taxation in accord with clearly recognised principles of theoretical justice have been in Prussia. That country has taken advantage from time to time of the advice of men of science. It has been doubly happy (1) in having a goodly number of unpartisan financial scientists to draw upon ; (2) in being able to draw upon them for advice, either by counting their pupils among its fiscal officers or placing the scientists themselves on its tax boards and commissions. It has been able to make changes with a broad conservatism that looked toward the gradual realisation of accepted ideals. With characteristic visionary eagerness, France has several times started out to obtain at a single bound some new ideal, but in France. has each time fallen back upon forms and methods but little better than those in vogue before. In England, special difficulties and objections have been met with little reference to any general plan. The result has been a steady approach to a better state of affairs, with only an occasional intensification of existing evils, due to the attempt to cure symptoms rather than to seek the underlying causes of the trouble. In the United States there have been spasmodic and ill-directed attempts at the removal of a few clearly recognised abuses ; and without any consistent attempt to change the system, the result has

Prussia made use of men of science.

Little advance in France.

England removes special faults.

No consistent reforms in the United States.

been a decided modification. The general failure of the property tax to reach personal property gave rise at first to vigorous efforts to extend and sharpen the methods of assessment. These attempts failing, other methods of reaching the mass of personal property were devised, which have resulted in a partial change of system wherever they have been successful.

SEC. 3. The most instructive country to study is Prussia. The line between the old and the new may be drawn at the reforms of Stein and Hardenburg in the forms of land tenure. These reforms may be regarded as having been accom- *Establishment of free trade in land in Prussia.* plished in 1811. Briefly stated, their result was to abolish personal serfdom,

dissolve the feudal partnership between tenants and proprietors, and establish free trade in land.¹ Although these reforms had to do mainly with land, and although the accompanying edict of 1810 promised speedy reform of the land tax on the basis of a new survey, or *cadastre*, nothing material was accomplished in the reorganisation of this tax until 1861. In that year the land tax was re- *The land tax.* arranged for the entire kingdom on the

basis of a new and rapidly executed survey. Some twenty different provincial land taxes, with up-

Seeley's *Life and Times of Stein*, Vol. I., pp. 187-297. Morier, "The Agrarian Legislation of Prussia during the Present Century," in Probyn [Editor], *Systems of Land Tenure in Various Countries*, pp. 306-316. See Selections in Rand.

wards of one hundred minor variations, which had existed before that time, were merged into an apportioned tax upon the net product of each piece of land as given in the *cadastre*. This tax recently yielded about 40,000,000 M. annually.

The reforms which preceded this were those of the indirect consumption taxes, out of which finally emerged the personal class tax. The *Consumption taxes transformed into personal taxes.* edict of 1810, which was referred to above as promising a reform of the land tax, seriously attempted to remove inequalities by destroying many feudal exemptions and privileges, and removing local differences. A general scheme of consumption taxes on necessities, of which the excise on meal is a type, was planned for city and country alike. It was, however, immediately found that the meal tax was hard to collect in rural parts. As early as 1811, therefore, a poll tax of one-half thaler from every person over twelve years of age was substituted for the meal tax in all places except the larger towns. In 1820 this tax, still applying to the same places, developed into a classified poll tax; *i.e.* all persons were grouped according to rank, profession, and general prosperity, into a few classes, which were then taxed *per capita* at different rates for each class. Somewhat modified the next year, so as to make twelve classes, in groups of three each, and with rates which ranged from one-half thaler to 144 thalers, and covering all persons over fourteen years old,

The class tax.

this tax endured thirty years. As before, this tax did not extend to the large cities, where the excise on meal and meat was regarded as placing the same burden on the people. Such a remarkably clear perception of the fact that indirect taxes are practically the equivalent of direct taxes in the individual burden they impose is not often met with in fiscal history.

In 1851, this tax was changed in order to make room for the introduction of an income tax on all persons having an income of over 1000 *The income* thalers. Those persons whose incomes *tax.*

were below this amount were taxed in the large cities by the meal and meat tax ; in the country and in small towns, by a class tax, like the old one, with rates ranging from one-half thaler to 24 thalers, according to the supposed income. Persons living in large cities who paid the income tax were allowed to deduct 20 thalers from their income as compensation for the meal and meat tax they were supposed to have paid. Later reforms removed these gate excises except for local purposes. As the income tax forms a special topic in a later chapter, we will not at present follow the details of its development and reform. It is sufficient to say that it was a progressive tax on the income of every person.¹

When the land tax was reformed in 1861, the building tax was separated from it, having been

¹ See Chap. IX.

until that time a part of it; and all old taxes of a similar sort were merged in the new one. This tax is assessed in the cities according to the rental of the buildings, and in the country according to the size of the lands connected with the houses, and other characteristics.

Building tax.

One of the reforms that was made after the peace of Tilsit to strengthen the weakened economic resources of the country was the establishment of general industrial freedom. Naturally, such a change would have been regarded as a failure from the standpoint of the statesmen of the times, if it could not be made to yield a revenue to the treasury; so the new industries were burdened with a new tax. This tax, which was very weak, and which, wisely, perhaps, failed to meet all the new forms of industry which came into existence, was subjected to a thoroughgoing reform in 1891. But it was at that time transferred to the local governments. Capital invested and some of the permanent features of each business form the basis of this tax.

Industry tax.

The Prussian system, as it existed before the great reforms of 1893, may now be seen as a whole. It consisted of two parts: (1) There was a group of three complementary taxes upon the produce of property and capital,—the land tax, the building tax, and the industry tax; (2) there was a system of personal taxes culminating in an income tax.

Summary of the Prussian system before the recent reforms.

The former group, true to the economic tenets of the first three-quarters of the century, taxed the productive agencies. The latter, although it originated as a consumption tax, aimed at taxing the shares in distribution. Thus the older consumption taxes, which were originally assessed without any very clear idea of what the justification was, but were used because productive of large revenues, yielded to new taxes supposed to be more fairly in accord with the modern system of distribution.

We are now in position to see the significance of the great reforms of 1893 (all of which went into effect in 1895), made under the *The great re-* leadership of *Finanzminister* Dr. Miquel. *forms of 1893.* These reforms place Prussia far in advance of all other countries in the theoretical perfection of her tax system.¹ The income tax, which has long been correctly regarded as the foundation of the Prussian tax system, was subjected to a thorough reform in 1891.² It was strongly urged at that time that income from property represented a far higher faculty, per unit, than income from labour and personal exertion, and, therefore, that a perfect system should contain two kinds of progression: one that taxed larger incomes more heavily than smaller ones; another that taxed incomes from property more heavily in proportion than incomes from labour.

¹ See Seligman, *Essays*, pp. 330-339. References to larger and more detailed statements are given there.

² See Chap. IX.

It was felt that the existing produce taxes (*Ertragsteuern*), the land, building, and industry taxes, failed to accomplish this end. Hence one of the reforms of 1893 was the surrender of these taxes to the communes, and the initiation of a general property tax as supplementary to the income tax. This tax, which can be properly understood only when its supplementary character is held in mind, is arranged as follows:

The tax is one-half per mill on the lower limit of the class within which the property falls. The classes go by stages of 2000 M. from 6000 M. to 40,000 M., of 4000 M. up to 60,000 M., of 10,000 M. up to 200,000 M., and above that of 20,000 M. each.

Thus:

PROPERTY				TAX
	Up to	6,000 M.	. . .	exempt.
From	6,000	" 8,000	" . . .	3 M.
	8,000	" 10,000	" . . .	4 "
	10,000	" 12,000	" . . .	5 "
	20,000	" 22,000	" . . .	10 "
	40,000	" 44,000	" . . .	20 "
	60,000	" 70,000	" . . .	30 " etc.

Above 200,000 M. the stages are 20,000 M. each, and the tax increases 10 M. in each stage.

This tax being supplementary to the income tax accomplishes the result of imposing a differential rate on funded income as against unfunded income.

The abandonment by the State of the three old taxes on land, buildings, and industry rendered the

reform of local taxation possible. As has already been said, the proper coördination of all tax burdens is one of the chief problems of modern tax reform. With the exception of the beer taxes, and the meat and meal taxes still used by some of the cities, local taxation in Prussia is mainly direct. Most of it, until 1895, took the form of percentages additional to the rates of the royal taxes. In some cities there were important special local taxes, like the house rent tax in Berlin. Prussia, also, grants subsidies from the royal treasury to the local bodies for special purposes. But the symmetry of the national system was somewhat destroyed by these additional rates. Such additions to the income tax were especially intolerable. Real estate is, moreover, a particularly good basis for local assessment. It cannot evade the tax, and it is the recipient of particular benefits from good local government. The same is true of businesses of a local character, although it is not safe to let the rate vary from place to place. Hence these three taxes were handed over to the local bodies. At the same time the attempt was made to regulate all other sources of local revenues.

The Prussian system as it now stands comes nearest to the realisation of the taxation of faculty of any in the world. The chief difficulties that have arisen are those of assessment. The progressive rate gives rise to a special incentive to the concealment of larger incomes, and not even the general excel-

lence of Prussia's administration has been preventive of under-assessment.¹

SEC. 4. In France indirect taxation has probably found a higher development than anywhere else. Indirect taxes yielded in 1908 over 2,000,000,000 francs, against 560,000,000 francs from direct taxes. Some of the main taxes are on the consumption of wine, spirits, beer, sugar, salt, tobacco, etc.; there are also the *octrois* or gate duties collected by some of the cities as a means of contributing their share of some of the direct taxes to the general treasury. There are also the taxes on acts and transfers, which will be treated under fees, since they assume a private benefit, and the customs duties. Not peculiar to France, but receiving a high development there, is the mode of collecting a tax on consumption by a monopoly of the manufacture of tobacco in the hands of the government. The imperative necessity under which France has laboured all through this century of continually increasing her revenues, and the danger of making the burden unbearable if thrown upon the existing direct taxes, as well as the desire on the part of the legislators of concealing so far as possible the actual burden, lest an impatient constituency rebel, accounts well for the relatively high development of indirect taxation. The preference for in-

¹ See the revelations of the Bochum investigations, quoted by Wagner in *Schanz Finanzarchiv*, XVIII. year, Vol. II., pp. 107, 108.

direct taxes as the main reliance of the public revenues argues, however, a low stage of political ethics. The more highly developed the consciousness of citizenship and membership in the State, the easier it is to make direct taxation effective.

Direct taxation in France dates in its present form from the Revolution. All the taxes of the ancient monarchy were abolished at that time and a fixed scheme of taxes on revenue-yielding property substituted. This system of direct taxes *The French* has four chief members: (1) the tax *direct taxes*.

on real estate, known as the "*impôt foncier*"; (2) the apportioned tax on polls and rents of dwellings, "*cote personnelle et mobilière*"; (3) the tax on doors and windows, "*impôt sur les portes et fenêtres*"; (4) the tax on business, "*impôt des patentes*."¹ Supplementary to these taxes are a number of taxes classed as "assimilated to the direct taxes." These, so far as they flow into the central treasury, are: (1) the mining dues, or the royalties from the mining rights, "*redevances des mines*"; (2) the fees for the certification ("*vérification*") of weights and measures; (3) the tax on property held in mortmain, that is, property held in perpetuity by the

¹ "*Patentes*" is translated by Leroy Beaulieu by "licenses." *Science des Finances*, Vol. I., p. 395. There is no exact English equivalent. The "license" in this case is little more than evidence of the payment of the tax. The term "patent" does not seem to imply, as the term "license" does, the granting of a special privilege. The term "license" is, however, not infrequently used in English to indicate a tax on business.

communes, hospitals, churches, seminaries, charitable institutions, and the like, "*taxes des biens de la main morte*"; (4) the taxes on horses and carriages, "*impôt sur les chevaux et les voitures*"; (5) a number of miscellaneous fees and charges of which the charges for the inspection of pharmacists, grocers, druggists, and herbists are examples.

The real estate tax, the poll and rents of dwellings tax, and the door and window tax are, in most part, apportioned taxes. The real estate tax was, down to 1890, a combined tax on agrarian lands and on land with buildings. It was apportioned *Impôt foncier.* on the basis of a very elaborate survey and valuation completed in 1850 and carefully kept up to date. These taxes, like the other apportioned taxes, were apportioned in successive steps, first to the *départments*, then to the *arrondissements*, and then to the *communes*, by the several legislative bodies, and finally divided among the individuals in each of the *communes* by a "*conseil de répartition*." In 1890 the tax on dwellings, that is, the tax on land with buildings on it (*propriété bâtie*), was separated from the agrarian land tax and the amount levied on the land was somewhat reduced. In 1897 further relief was granted to small landed properties. In 1908 the *impôt foncier* yielded 200,000,000 francs. The land tax is still an apportioned tax, but that on dwellings, or on *propriété bâtie*, is now proportioned, and the uniform rate is about 3.2 per cent.

The tax on polls and rents of dwellings is peculiar

to France, the same combination not being found in the tax systems of other countries, although the elements thereof are not uncommon. This tax, the *personnel-mobilier*, as it is called, is two *Personnel*-taxes in one, a tax on polls and a tax *mobilier*. bearing the somewhat misleading designation "*mobilier*." This latter tax was originally designed to cover personal property, hence its name, and thus to supplement the *impôt foncier*. The personal or poll tax element of this tax is due from every citizen of France and from every resident enjoying civil rights, except paupers, married women living with their husbands, and children, whether of age or not, living with their parents or guardians, and not enjoying an independent income. It is the same in rate for all the inhabitants of a given locality and the rate is fixed at three days' wages. The rate at which the wages shall be assessed is determined each year by the general council of each *département*. It may, however, not be fixed at less than one-half franc, nor at more than one franc and a half. Thus the minimum tax is one franc and a half and the maximum four francs and a half. The other element of this tax, the *mobilier*, is assessed according to the rental value of inhabited houses. It is in this part of this two-headed tax that the apportionment is worked out. The poll tax falls short of raising the commune's share of the combined taxes, and the balance of the quota is assessed upon the rentals of dwellings (*loyer de habitation*). Some of the large

cities, Paris, Lyons, Marseilles, and a few others, raise a part or even the whole of their quota by means of duties on goods brought into the cities, *i.e. octrois*, and do not levy on rentals.

The door and window tax is an apportioned tax rated according to the number of windows and doors in the houses. It was intended
Portes et doors in the houses. It was intended
fenêtres. to supplement the personal and dwelling tax, but it is really an addition to the real estate tax. It is paid by the owner and he is allowed to shift it if he can to the tenant.

The business tax is an old one. Established in 1791, remodelled in 1844, it is now enforced under a law that was adopted in 1880. Unlike the other direct taxes it is regarded, not as an apportioned, but as a proportioned or rated tax. The
Impôt des but as a proportioned or rated tax. The
patentes. "*impôt des patentes*" is imposed on every person, native or alien, who carries on any trade or profession in France, except agriculture and a few others that are especially exempted. The aim is to tax the profits of industry or of a profession, as nearly as may be proportionately. The methods of determining the rates for the different occupations or industries are extremely complex, so much so that only the most general outline can be attempted here. The objects of this complex system of rates are to avoid on the one hand any inquisitorial prying into the affairs of the individual taxpayers, and on the other hand to shun the danger of receiving false declarations as to the amount of the profits. This is

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done by seizing upon certain concrete, external signs, or natural and obvious characteristics, as evidence of the size of the profits. In general the rates fall into two parts. The first is called the fixed duty (*taxe déterminée*). This is the same for each occupation of the same sort, and is largely independent of any of those conditions which make one occupation more profitable than another of the same kind. The second is the proportional rate, based on certain characteristics that are assumed to indicate that a given industry is more or, as the case may be, less profitable than another of the same kind. The fixed duty, however, is not the same in all towns, for it is assumed, for example, that a druggist in a large town makes larger profits than one in a small place. For the fixed duty occupations are grouped in three classes and fall under schedules A, B, and C of the law. Class A includes the general run of merchants and artisans. Merchants are again divided into three classes, according as they sell entirely at wholesale, partly at wholesale and partly at retail, or entirely at retail. In this class the fixed rate is based on two considerations, (1) the nature of the business and (2) the size (population) of the place in which the business is conducted. Thus occupations are divided into eight general classes according to their nature, and for each of these there are nine ratings according to the size of the place in which they are located. Class B contains a number of businesses in connection with which it seems neces-

sary to consider the size of the enterprise as well as the size of the place and the nature of the business. So a third set of characteristics is introduced supposed to show the size of the enterprise. In this class are bankers, department stores, water works, hack and omnibus companies. Class C includes the smaller industrial pursuits, handicrafts, and the like. In this class the size of the place is not taken into consideration, but some concrete index of the size of the establishment is taken in connection with the nature of the business. Such indices are the number of appliances, or machines used, the number of workmen employed, and the like. The proportional part of the rate is based mainly on the rental of the place of business and the rental of the home the proprietor occupies. It varies for each of the main classes and also within the classes. These rates are for class A from two to five per cent of the rental, for those in class B ten per cent, in class C from one and two-thirds to ten per cent. The "liberal" professions, such as those of lawyers, doctors, and the like, pay only the proportional rates.

Direct taxation in France may be summarised as falling mainly on the agents of production and the sources of wealth.

SEC. 5. The English system of taxation can be very briefly treated here, because the principal component parts will be discussed in detail in later chapters. What is necessary here is to give an outline of the system as a whole. The greatest

change in the British scheme of taxation within this century was the elimination of the protective principle from the customs duties,—and indirectly from the excises also,—brought about in the period from 1840–1850, by the abolition of the corn laws and the agitation leading thereto. The consequent simplification of both the import duties and the excises rendered it possible to manage them purely as a source of revenue with a view to obtaining relatively larger sums. The customs duties, the entire tariff of which now contains only 40 rates, and the somewhat more numerous excises and stamp duties, pay one-half the total annual revenue. The property and income tax, which was restored in 1842 and has since been the variable or elastic element in the system, will also receive special attention in another chapter. Inasmuch as this famous property and income tax is a system, in itself, of five taxes which are calculated to fall upon the chief sources of wealth, it complies, in a way, with the requirements of universality. Its rate is degressive, so that it attempts to comply with the requirements of justice. It may be looked upon as the complete system of direct taxation. Outside of the system there are two remnants of older taxes which are anomalies and destroy, somewhat, the logic of the system. This lack of any logical reason for retaining them does not necessarily form any good reason for abolishing

them. They give rise to no serious complaint, they are old and have been in the main capitalised, so that they form no real burden at present. They are the land tax of the eighteenth century, which is now a redeemable rent charge, and the house duty. This latter developed out of the hearth tax of 1662. In 1688 it had been replaced by a window tax. In 1778 a tax on the annual rental

The house tax. was added to the window tax, and finally after 1851 this tax on the rental value was left to stand alone.

There is still another tax which supplements the property and income tax, and that is the inheritance tax. The most recent changes in these *The inheritance tax.* inheritance taxes, — “death duties,” — which have existed in England since 1694, will receive attention under another heading. The important thing to note in this connection is that these taxes have introduced the principle of progression very extensively into the tax system of England.

The English system as it now stands, consists (1) of the customs and excise duties ; (2) of the so-called property and income tax, a degressive tax upon five kinds of income ; (3) two older taxes, the land tax and the house tax ; (4) a graduated inheritance tax, and (5) a number of stamp taxes on deeds, receipts, and so forth.¹

¹ Williams' *The King's Revenue* contains a fine outline of the revenue system of England. It is one of the best books of its kind ever compiled.

The different authorities that have had the power to levy local rates in England are very numerous. The whole system is very complex. The different rates, each going by the name of the authority that levies it, or the purpose for which it is collected, are mostly upon the same base ; namely, the annual rental of the various tenements. They are generally levied upon occupiers. In the case of tenements of less than £10 annual value, the difficulty of collecting from the occupier is so great that the plan of making the landlord advance the tax has been adopted. He then shifts it to the occupier. The recent reforms of county and municipal government in England have resulted in a simplification of local rates.

SEC. 6. Like the English, the American system can be but briefly treated here, since many of the taxes will receive our attention in subsequent chapters. The principal federal taxes have been customs duties and excises. The states, or commonwealths, have confined themselves rather closely to direct taxes, as have also the minor civil divisions. Down to 1840, commonwealth taxation was very meagre. Many of the states attempted to get along without recourse to taxation at all, depending for revenues upon the sale of lands, fees, and other sources.

The evolution of taxation in this country during this century has resulted in little advance. Indeed it has been to make confusion thrice confounded. Not only has difficulty been found in adjusting the spheres of the

*The absence of
sound principles.*

different taxing authorities, but no sound principle, indeed scarcely any principle at all, has been followed. Before the Revolutionary War the general property tax, whose origin we have already seen, answered the requirements of justice and equality fairly well. As has been frequently remarked, the American people were a saving race. As fast as they created wealth they turned it into property. The forms of property were, even when not immovable, tangible and unconcealable. Real estate formed the mass of it. Movable property consisted of furniture, farm utensils, and cattle. There were few stocks or bonds, or other forms of credit in which to invest wealth. Among such a people a tax levied on property that was easily ascertainable answered all the requirements.

But as intangible personal property increased, as opportunities for investment multiplied, it became impossible to make the property tax "general." It became a tax on real estate except for the few conscientious persons who declared their personal property. Until about 1900 the commonwealth legislatures made but half-hearted attempts to sharpen the procedure of assessment. Since that date a number of the states have introduced a plan of central control of the local assessors by a strong central commission. Wherever adopted this has resulted in marked improvement in the direction of greater equality. Prompted at first by a wave of popular excitement,

The property tax not "general."

which took the form of a feeling of bitterness toward certain classes of capitalists, the legislatures have, from time to time, attempted to reach personality by taxing the corporations in which the untaxed funds were invested. *The corporation taxes introduce a new principle.*

The resulting corporation taxes worked some improvement. They supplement the general property tax very effectively. Within the past decade (1899-1909) a number of states have been remodelling their tax system, by selecting certain sources of revenue for the use of the state or central governments only, leaving the general property tax to the minor civil divisions. One general result of this movement has been the taking over of the taxation of corporations by the state, with corresponding increase in efficiency of administration. Sometimes the legislatures have attempted to tax mortgages, as if they were a part of the property on which they rest. *Taxation of mortgages.* As mortgages have to be recorded in order to be legal, it is possible to get at the full value. In some commonwealths, then, the mortgagee is taxed on his interest in the property and the owner is exempt to that extent. In California, where this plan has been most extensively tried, the result has not been at all what was desired. The only effect has been to raise the rate of interest on mortgages by the amount of the tax plus from one-fourth to one per cent. That is, the mortgagees have succeeded in shifting the burden of the tax to the real owners with a handsome addition for

their trouble. Such a shifting is always possible when any one form of capital is taxed, leaving other forms untaxed, either because they are exempt or because they escape the tax. A recent development in some states has been the exemption of mortgages from taxation as property under the general property tax and the substitution of a tax at a low rate, known as a recording tax. But in general and in most of the commonwealths the American system remains what it has been since 1840, — a regressive tax on real estate, supplemented in part by corporation taxes in some commonwealths, and by an ever increasing number of inheritance taxes. It is a system condemned by every scientific writer and impartial statesman, but retained as the only source of revenue.

The difficulties which have prevented persistent attempts at reform remain, and it is hard to see how they can be overcome. No one commonwealth can afford to pursue personal property with so much vigour as to actually impose a tax on all of it. Only concerted action could accomplish this. Capital is sufficiently mobile to move easily from commonwealth to commonwealth, and if compelled to bear its fair share of the burden in one and not in another, it will surely migrate. Legislators are extremely desirous of attracting capital and very wary of repelling it. The owners of capital cannot be taxed personally. They change their residence from city to suburb

*The difficulties
in the way of
reform.*

and even to unfrequented rural parts on the slightest increase of local taxation and move from commonwealth to commonwealth with equal facility. Residence, too, is a matter of intention, and it is easy if personal taxes are proposed to plead residence in another commonwealth. Concerted action being practically impossible, the tax-dodger is safe.

But while the present system is very bad, it has been tolerated in the past, and arouses less discontent at present than might be expected *Reason for the toleration of the system.* because it falls mainly on the receivers of economic rent. The value of land in many parts of the United States has increased very rapidly and is still increasing steadily; so that in those parts, while the taxed owner feels the burden severely, he consoles himself with the thought that he is largely or wholly reimbursed by the increased price which he hopes to get for his land. The general practice, too, of assessing real estate at a fraction of its value, even though so universal as to work no actual lessening of the burden in any individual case, tends to stifle murmurs of discontent. For the owner secretly congratulates himself on not having to pay on all of it,—an illogical basis for self-congratulation, to be sure, but still not infrequently effective. The same person, too, is not infrequently the owner of taxable personal property which he conceals, and he is less uneasy about the tax on real estate so long as he is able to save the other.

Another reason for the absence of a concerted movement of real estate owners to lessen the burden arises from the fact that the real estate tax is a real burden on the property, and shifts itself by the process of capitalisation. For the new purchaser gets his property at a lower price than he would have to pay if the tax had not been imposed. The frequency and ease with which real estate changes hands gives constant occasion for this capitalisation of the tax. Every real tax, when not a part of a well-organised system which taxes every kind of property or all receivers of wealth, can be shifted in this way. It becomes a rent charge on the property to which it is thus attached. A dim perception of this, and a possible realisation of the fact that a reform of the tax system might transform this tax into an actual burden again, may lie at the bottom of the indifference with which the average landowner views proposed reforms.

All of this selfish indifference is, of course, mistaken. It defeats its own ends. The burden of taxation is only light when properly adjusted to all the shoulders. The serious effects of an unjust, unequal, and ill-arranged system of taxes upon the economic forces of the country has been treated elsewhere. The property tax forms the subject of a special chapter.

We have spoken merely by courtesy of an American *system*. As a matter of fact there is none that

is worthy of the name. Federal authorities tax with no reference to commonwealths and municipalities; commonwealths and municipalities, without reference to federal action. Municipal taxes are, however, generally adjusted to the existing commonwealth taxes, but only in such a way as not to make the resulting burden appear too large. Their efforts in this direction have only served to intensify the existing inequalities.

CHAPTER VI

EXCISES

SECTION 1. Generally speaking, indirect taxes are older than direct taxes. They are suitable to a more primitive organisation of society. Hence, it will not be amiss to treat them before we analyse the direct taxes. By far the larger part of the

*Comparison
of excises and
customs.*

indirect taxes are on consumption (*Aufwandsteuern*). Most of the taxes on consumption fall under one or the other of two heads: they are either excises or customs duties. In the United States the excises are called internal revenue taxes. Excises may be defined as all those taxes levied within a country on commodities destined for consumption. Customs duties fall on commodities as they enter or leave the country. In their effect on the economic condition of the country and on the tax-bearer they are practically the same. In both cases the persons who first advance the taxes are generally supposed to reimburse themselves from the persons to whom the wares are sold. In both cases, although less often in the case of excises, it may be true that only a part of the funds taken from the tax-bearer flows into the treasury. For both of them enable producers who escape, or whom

it is not intended to tax (as the home producer in the case of a tax on imported commodities), to collect on each piece of goods sold a bounty or a tax in the form of a price higher than he could otherwise obtain, the amount of which goes into his own pocket. Sometimes this subsidising of certain producers is intentional, sometimes only accidental. In any case the ultimate effects which will result from such an interference with the ordinary currents of trade cannot be fully traced. It is comparatively seldom that excises have been intentionally used to change the movement of economic life. But customs duties have regularly been used for that purpose. Excises have, to be sure, been used to influence social life, to lessen the consumption of certain commodities the use of which is regarded as injurious to the individual or dangerous to society, but the object, in that case, is social, not economic.

There used to be a large number of the so-called direct consumption taxes. A few of these still survive. They are direct in the first sense of that term, but not in the second. These direct taxes on consumption are either remnants of the older taxes on movables, or arose from the attempt to frown on the use of luxuries. They differ from excises in that they are levied directly on the consumer and not on the person or persons who supply him with the commodities. They are to-day few in number and of little fiscal

Excises have sometimes been used for moral reforms.

Direct consumption taxes.

importance. The chief instances in modern times and the most universal are the dog taxes. There are, in England, similar taxes on guns, carriages, armorial bearings, and men servants. In the United States watches, clocks, and firearms have been made contributory in this way. Plate, houses, clocks, hair powder, and a great many other articles have been taxed. It is regarded as just and proper to make articles of luxury the subjects of taxation because their use is supposed to be evidence of ability to pay. The tendency now is to leave the administration of direct consumption taxes to the local bodies. They are sometimes combined with police regulative laws and are assessed as a means of enforcing those ordinances. This is the case with the dog tax in America.

SEC. 2. It is the excise tax in all its forms that has displaced the direct consumption taxes. The distinguishing feature of this tax is that some resident seller of an article, whether produced in the country or abroad, or the manufacturer of such an article, advances the tax either during the process of its production or at some time before it reaches the consumer.

Some excises have the same purpose as sumptuary laws.

The main purpose of the excise is to obtain revenue, but the ideas underlying the sumptuary laws, and the desire to use taxation as a means of social and moral reform, have dictated some of these taxes or at least the selection of the commodities to be taxed. The fact that the consumption of certain articles like spirituous liquors, tobacco, and

playing cards is condemned in itself, and that such articles are regarded as unnecessary luxuries, has led governments to disregard, or, indeed, to favour, the repressive tendency of the tax upon the use of them. It is felt that in case the tax should lessen the consumption, the gain to the community in moral and social well-being would more than offset the loss to the treasury in revenue. Moreover the consumption of such articles is not, it has been found, liable to serious diminution on account of the tax, unless, as in the case of the French tax on tobacco, it is very high.

In the seventeenth century there was a marked tendency to multiply excise taxes. So strong did this tendency become that not a few able writers advocated a general excise as the most just form of tax.¹ Many of the recent suggestions for the reform of taxation in France are in the same direction. This

An exclusive system of excise taxes would be unjust.

tendency can be easily explained by the rapid multiplication of taxable commodities. It was urged that the ease with which such taxes were shifted insured in the end perfect justice. It was also often urged that consumption is more or less voluntary, and any one who finds the tax too heavy can avoid it or lessen it by curtailing his consumption of the taxed article. Thus if the taxed articles are not important necessities, the contributor has a certain control over his share of the tax and can suit it to his means. If the tax is on a luxury, he has presum-

¹ Cf. Cohn, p. 336; Seligman, *Shifting and Incidence*, p. 12 ff.

ably absolute control over his contribution. But modern investigations into the character of distribution and consumption would seem to indicate that these views are erroneous. There is no doubt that consumption is a very poor criterion of tax-paying ability. What a man spends is no indication of his tax faculty. There are, also, some important administrative difficulties. The yield of these taxes is

An exclusive system of excises inexpedient.

beyond the control of the fiscal officers. If more revenues are needed, it is not always possible to obtain them by raising the rates, since a rise in the rate may, in fact, lessen the revenues by lessening the demand for the articles. Therefore, they are not variable at the pleasure of the treasury. It follows, further, that a system of excises alone would be extremely inelastic. But as parts of a system, the elasticity of which is provided for by other elements, they have proved very valuable on account of the relative ease of

Used in connection with other taxes.

collection, and the large returns which they can be made to yield. In England, Russia, and France the returns of the excises and customs duties are one-half, or more of the national revenues. In Germany the constitution confers upon the Imperial legislature the power to regulate the customs and excises upon domestic productions of salt, tobacco, spirituous liquors, beer, sugar, and syrup.¹ The commonwealths of the Empire do not levy excises on the

¹ Burgess, *Political Science*, II., p. 174.

articles above mentioned except Bavaria, Würtemberg, and Baden. The Empire cannot tax any other articles. In the United States the federal government derives nearly half its revenues from excises and an almost equal amount from customs.

The following principles have been developed as governing the returns obtainable from excises :

(1) Articles which are regarded as necessities, and which naturally have or can *Excises on necessities.* have a wide consumption, are very suitable under this tax for obtaining large revenues. In this case the operation of the tax is like that of a poll tax. The old French *gabelle*, a tax on salt, is an example. The effect of these taxes, if high, is possibly to curtail consumption and possibly to cause a substitution of other similar articles not taxed. Possibly, too, they may curtail the consumption of other articles by lessening the money available for their purchase. But even with a low rate, these taxes are extremely productive of revenue, on account of the large number of contributors. The objection to burdening necessities and rendering the existence of the poor harder, leads, however, sooner or later, to their abolition or to a reduction in their rates. These, like the poll taxes, recognise too small an extent differences in ability. They are, however, *Excises on luxuries and comforts.* good sources of revenue in cases of extreme need. (2) Luxuries and comforts may be taxed heavily. This applies especially to luxuries the use of which has become a fixed habit

with large masses of people. The general principle is to select those luxuries of the widest consumption as the objects of the heaviest taxes. Thus alcoholic liquors and tobacco are universally taxed in this way. In the United States they form almost the sole objects. In times of special need it is customary to press the semi-luxuries or comforts into service. Here again, the choice is made of articles of widest consumption; such as coffee, sugar, silks, chocolate, etc. In most modern excise systems, the heaviest burden falls upon luxuries. In England, where the receipts from excises are nearly one-fourth of the total revenues, the chief burden falls upon spirits (1908, £22,830,000) and beer (1908, £13,550,000). In France, aside from the *octroi*, the chief excises are on beer, wine, spirits, and tobacco, then on sugar, salt, and playing cards. In Germany, apart from the city gate taxes, they fall upon alcoholic drinks, tobacco, and sugar. There are special difficulties which Germany encounters in the administration of these taxes, due to deep-seated historical prejudices on the part of the commonwealths of the Empire. Modern excises are, then, mainly taxes on alcoholic drinks and tobacco with the addition of a few other duties upon playing cards, etc., and in cases of great need, upon a few articles of large consumption.

SEC. 3. By far the most interesting features of the excises are the methods of assessment and collection. These are practically of three kinds, which may be variously combined:

*Methods of
assessment.*

(1) A tax on the producer or seller so levied that the failure to pay it deprives the person of the right to sell, and renders him liable to penalty. That is, a so-called license¹ is sold. (2) An impost on each unit of the article. This demands the registration of the dealers therein; and sometimes they are required to give bonds as surety for the payment of the tax. Wherever it is possible, this impost is collected by means of the sale of stamps purchased of the government to be affixed to each package, hogshead, etc., or by means of brands, or other marks affixed by officials who thus receipt for the payment. The stamp or brand serves as evidence that the tax has been paid. Goods not bearing these would, if taxable, become contraband and liable to seizure. (3) By the retention of the monopoly of manufacture and sale by the government.

England and America use a combination of (1) and (2). Thus in England every barrel of beer is taxed 7s. 9d. (1908) and every dealer and brewer pays a license besides.²

¹ For the distinction between a license and a permit see the United States Census Bureau definitions cited in the Appendix to Chap. I. of Part II. of this work. A license to conduct some business illegal in itself differs from a license required merely to compel the payment of a tax.

² The following applies to 1908 :

BEER DUTY, EXCISE		£	s.	d.
Beer of specific gravity of 1055 degrees, per 36 gal.		0	7	9
ANNUAL LICENSES				
Brewers of beer for sale		1	0	0
Other brewers :				
Brewing solely for their own domestic use, exempt				

In the United States all internal revenue taxes are payable by stamps. These stamps are pasted upon the packages containing the taxed commodities in such a way as to be necessarily broken when the package is opened. Or else they are pasted up

from beer duty, if the annual value of the house occupied does not exceed £8 (exempt)	£	s.	d.
Same, if annual value of house exceeds £8, but does not exceed £10	0	4	0
Same, if annual value £10 to £15	0	9	0
Same, but liable also to beer duty, over £15	0	4	0
Same, or for consumption by farm labourers, if annual value of house does not exceed £10, exempt from beer duty	0	4	0
Same as last, if over £10, liable also to the beer duty	0	4	0
Beer dealers	3	6	1
Beer dealers, additional to retail, off the premises	1	5	0
Beer retailers, on the premises	3	10	0
Beer retailers "on," occasional (license per day)	0	1	0
Beer retailers, grocers, "off," Scotland, to £10.	2	10	0
Beer retailers, grocers, "off," Scotland, £10 and upward	4	4	0
Beer retailers, grocers, "off," England	1	5	0
With varying and additional licenses for combination of sale of beer with wine, spirits, etc.			

Spirits are taxed in a similar way and so are the dealers therein. In the case of tobacco the import duty forms the tax on the commodity, and the manufacturer pays a license graded according to the size of his business.

Tobacco manufacturers :

Under 20,000 lb.	£	s.	d.
20,000 to 40,000 "	5	5	0
40,000 " 60,000 "	10	10	0
60,000 " 80,000 "	15	15	0
80,000 " 100,000 "	21	0	0
100,000	26	5	0
	31	10	0

or exposed in the places of business. The table below illustrates the whole system.

Schedule of articles and occupations subject to tax under the internal revenue laws of the United States in force August 28, 1894, as amended to 1908.

SPECIAL TAXES

	Rate of tax
Rectifiers of less than 500 bbl. a year	\$100.00
Rectifiers of 500 bbl. a year, or more	200.00
Retail liquor dealers	25.00
Wholesale liquor dealers	100.00
Retail dealers in malt liquors	20.00
Wholesale dealers in malt liquors	50.00
Manufacturers of stills	50.00
And for stills or worms, manufactured, each	20.00
Brewers, annual manufacture less than 500 bbl.	50.00
Brewers, annual manufacture 500 bbl., or more	100.00
Manufacturers of oleomargarine	600.00
Retail dealers in oleomargarine	48.00
Wholesale dealers in oleomargarine	480.00

DISTILLED SPIRITS, ETC.

Distilled spirits per gallon	\$ 1.10
Wines, liquors, or compounds known or denominated as wines, and made in imitation of sparkling wine or champagne, but not made from grapes grown in the United States, and liquors, not made from grapes, currants, rhubarb, or berries grown in the United States, but produced by being rectified or mixed with distilled spirits, or by the infusion of any matter in spirits to be sold as wine, or as a substitute for wine, in bottles containing not more than one pint, per bottle or package . . . . .	.10
Same, in bottles containing more than one pint, and not more than one quart, per bottle or package . . . . .	.20
And at the same rate for any larger quantity of such merchandise, however put up, or whatever may be the package.	
Stamps for distilled spirits intended for export, for expense. . . . .	.10

TOBACCO AND SNUFF

	Rate of tax
Tobacco and snuff, however prepared, manufactured, and sold, or removed for consumption or sale, per pound 12 cents, or with discount of 20 per cent	\$.09 $\frac{1}{10}$ net

CIGARS AND CIGARETTES

Cigars of all descriptions made of tobacco or any substitute therefor, and weighing more than 3 lb. per thousand	\$3.00
The same, weighing not over 3 lb. per thousand, per thousand . . . . .	.54
Cigarettes, weighing not more than 3 lb. per thousand and of a wholesale value or price of more than \$2 per thousand, 36 cents per pound, or per thousand	1.08
The same of a wholesale value or price of not more than \$2 per thousand, 18 cents per pound, or per thousand . . . . .	.54
Cigarettes, weighing more than 3 lb. per thousand, per thousand	3.60

FERMENTED LIQUORS

Fermented liquors, per barrel, containing not more than 31 gal.	\$1.60
More than 1 bbl. and not more than 1 hogshead, 63 gal., in one package	3.20

OLEOMARGARINE

Domestic, per pound	\$.02
Imported, per pound15

OPIUM

Prepared smoking opium, per pound	\$10.00
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PLAYING CARDS

Playing cards, per pack, containing not more than 54 cards	\$.02
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SEC. 4. We may now look at a few characteristic excises. The taxation of salt by means of an excise, collected in the form of a tax on producers, a tax on sellers, the sale of a *The salt tax.* monopoly to a private company, or state manufacture, is one of the oldest forms of taxation. On account of the nature of the commodity, a necessity for which there is no substitute, and of which poor and rich consume about the same amount, this tax acts practically as a poll tax. With the modern tendency to abolish or at least to lower poll taxes, as unequal and unjust, the salt tax has been largely abolished, or its rates have been so lowered as to practically nullify the returns. France in 1908 received about 10,000,000 francs from the salt excises. The English salt tax yielded at the time of its abolition only £380,000. The United States war excise upon salt yielded only \$300,000.

The best, but not by any means the sole, example of the tobacco monopoly is in France. This interesting tax scheme began in 1674 under Colbert. It continued with slight interruptions for over a century as one of the most productive parts of the revenue system. It was leased to a *ferme* *French tobacco monopoly.* *générale*, who paid the government, at the time of Necker, 32,000,000 francs annually. At the time of the Revolution the monopoly was abolished, and an attempt was made to introduce a series of taxes on tobacco. But the monopoly was restored in 1810 by Napoleon I., and has continued ever since.

Under the present law the culture of the plant is forbidden outside of certain localities. Each year the estimated amount required by the department is apportioned among the different applicants within the district where it is permitted to raise tobacco. Several thorough official inspections of the fields and crops are made, and even the number of plants and leaves is counted to insure obedience with the regulation which demands the delivery of the whole crop to the government. Tobacco raised for export is similarly watched to see that none of it escapes into the channels of the French trade. The price for each quality is determined by a commission of officials and experts. A part, about one-half, of the supply is imported. The manufacture is carried on in public factories, which employ about 20,000 workmen. The sale is in the hands of some 40,000 petty officials, who receive a percentage of their sales and whose appointment is a part of the party spoils system. The revenues obtained in this way are enormous :

1815	40,000,000 francs.
1869	197,000,000 "
1872	218,700,000 "
1876	262,300,000 "
1880	284,000,000 "
1885	300,000,000 "
1890	373,000,000 "
1895	381,000,000 "
1900	415,000,000 "
1904	447,000,000 "
1908 with matches	516,000,000 "

The prices charged for tobacco are high compared with the prices prevalent in other countries, so high that the consumption is apparently checked thereby, it being per capita less than one-half that of Germany. Austria and Italy have very similar state tobacco monopolies. France added a monopoly on matches in 1890.

SEC. 5. On account of the large returns obtainable from an excise on luxuries, and in view of the fact that any repressive effect of such excises is not felt to be harmful, but is often desired, it is probable that these *The proper field for excises.* taxes will be long retained. They are applicable to any luxury the consumption of which is large and of which the production is sufficiently simple or concentrated to allow of supervision. But in general, excises as taxes on expenditure or consumption are unfair. What a man spends is no indication of his ability to pay taxes, and what a man spends on a certain limited list of commodities is less so. When these taxes are made a subordinate part of a system and due allowance is made in the other taxes for the existing burdens, there is less objection to them.

CHAPTER VII

CUSTOMS DUTIES

SECTION 1. Customs duties are taxes levied upon commodities when they cross the national boundary line, or are admitted within a customs territory, consisting of a combination of countries or of definitely limited parts of countries. Unless a city or town forms an independent sovereignty, taxes levied on goods entering a city are not called customs duties, but *octrois* or imposts, and partake of the nature of excises. Duties upon goods passing from province to province in the same country are likewise not customs duties; neither are tolls or transit duties charged upon goods passing through the country. Such charges are fees for the ostensible or real service of the government in keeping up roads and bridges, maintaining peace, and allowing transit.¹ Customs duties are indirect consumption taxes of practically the same character as excises. Their treatment in a separate chapter is not on account of any actual difference in

¹ Cf. Bastable, p. 552, for contrary view. Bastable does not recognise fees as a separate class. Hence his identification of transit duties with customs duties.

nature but because of their historical and fiscal importance.

SEC. 2. The oldest forms of customs duties were on exports and imports alike. They arose by analogy from the transit tolls which were customary in the middle ages. Once in use their fiscal importance was recognised, and it was easy from the standpoint of feudal politics to justify their continuance. Feudalism regarded every act of the vassal as the concern of the lord. If any vassal, or later any subject, found a new means of gain, feudalism imposed on him the duty of contributing a part thereof to the lord or the king. If a subject sold a commodity to a foreigner it seemed to the men of the middle ages that the king's interests were affected, and it seemed right that his permission should be paid for. The export duty is often a sort of compromise accepted for the removal of the prohibition of exportation. With the decay of the older, cruder, mercantile ideas and the advent of a period when national wealth came clearly to depend upon the size of national trade more than on its direction, export duties fell away. It is interesting to note in this connection that England has been using, even in very recent years, an export duty on coal, originally for the protection of her deposits from depletion. In 1901 this duty was restored in order to obtain revenues for war purposes. The yield in 1905 reached £2,500,000. The duty was repealed in

*Old customs
duties covered
both imports
and exports.*

*The fall of ex-
port duties.*

1906. Turkey and India are now the only countries where export duties form an important item of revenue. India is the only country in which the export duties exceed the import duties.¹ In Turkey the duty is 1 per cent of all exported commodities. Switzerland, Austria, Russia, and Italy have a few export duties upon products peculiar to their soil, the burden of which is supposed to fall upon the foreigner. France did away with them in 1881, Germany in 1873.

Import duties are still very numerous. As a branch of the taxes on consumption, their yield is very large. The German customs duties yield nearly one-half of the imperial net receipts. Until recently about half of the United States federal income was from this source; now it is slightly less in proportion. The English customs duties yield about 23 per cent (1908) of the gross receipts, the French 15 per cent, and the Italian the same.

SEC. 3. Although the fiscal interests are great, yet in every important country except England the receipts from this source are not regarded as of any greater importance than the effects upon the industries of the country. There are then two sides from which these taxes must be studied: (1) from the side of the revenue-yielding capacity; (2) from the side of the "protection" afforded the industries of

¹ Export duties are still levied in the Philippines and are regarded as necessary for the taxation of the industries of the islands. They fall on sugar, hemp, and tobacco principally.

the country which levies them. While it would be undesirable to introduce a full discussion of the far-reaching economic effects of protective duties upon industries and commerce in a treatise on finance, yet a brief statement of these effects and of the main reasons which have led great nations to adopt these taxes is essential to an understanding of their nature. It is as essential to know how and why protective duties are intended to alter the existing economic conditions, as it is to know how and why the income tax, for example, is supposed to leave them unaltered.

The purposes of the customs duties both fiscal and political.

SEC. 4. What is the distinction between a protective tariff and a tariff for revenue? It may be briefly stated as follows: a protective tariff is a scale of duties so arranged as to prevent importation, wholly or in part, and to raise the price of commodities from abroad, the production of which within the country it is intended to encourage. The scale of duties is therefore arranged with a view to the supposed needs of the industries which it is intended to develop. A tariff for revenue, on the other hand, aims to avoid any effect upon industries within the country, and the duties are laid according to principles similar to those of the excise upon articles of large consumption and great tax-bearing capacity. The term "a tariff for revenue only," so current in the United States, is the expression of an unattainable hope. A moment's consideration of

Protective tariff defined.

Revenue tariff defined.

the law of international exchange,¹ namely, that the interchange of commodities between distant places is determined by differences in their possible cost of production in the same place, and not by their absolute cost of production in the separated interchanging places, will reveal the fact that even a very small duty upon a single commodity affects the demand of the country from which that commodity comes for other things, and indirectly affects every commodity manufactured in the country laying the tax. The same is true of an excise. In fact, any consumption tax has far-reaching effects. Strictly speaking, there can be no such thing as a tariff for revenue *only*. What is meant by that phrase is that the tariff shall be so arranged as to yield the needed revenue with the least possible effect on the trade and industry of the country.

It must be noticed that every tariff, even though it contains many protective features, also, necessarily contains many duties which are mainly for revenue. Thus in the United States, even with high protective duties, the main revenues were obtained from the taxes upon a few commodities. The receipts in 1888, for example, were : from duties on sugar and the like, \$52,000,000 ; from wool and woollens, \$37,000,000 ; from iron and steel, \$21,000,000 ; these three together being more than half the entire receipts from customs duties.

SEC. 5. The protective principle is widely applied

¹ See Mill, *Prin.*, Bk. III., Chap. XVII.

in every important existing tariff of customs outside of England, Holland, Norway, Belgium, Switzerland, and Denmark. This policy is clearly the outcome of national selfishness. The attempt to direct industry into certain lines by artificial means cannot find support in any system of political economy that regards the largest possible world's product as the proper aim.¹

*Protection as
a national
policy.*

The object is rather the greatest possible diversity of home products. In so far as this purpose is attained, it is by the process of shutting out competition and allowing the home producer to collect from home consumers a certain amount of support, greater or less, according to the supposed needs of the producer in question. In so far, then, the actual production afforded is an item of public expenditure. Revenues collected by means of higher prices authorised by law are spent in developing the industry protected. It is in every respect the same as if a subsidy were paid to the manufacturer or other producer, except that the money goes directly to him without first passing through the treasury.²

¹ See the article by Professor Folwell on "Protective Tariffs as a Question of National Economy," in *The National Revenues*, a collection of papers by American economists, edited by Albert Shaw, Chicago, 1888. Contrary to the popular opinion as to the views of economists, none of the writers who have contributed to this symposium finds it possible to attack protection on *a priori* grounds. On the free-trade side see Report of the Proceedings of the International Free-trade Congress, London, August, 1908. Cobden Club, Caxton House, Westminster, Sw. London, 1908.

² See above on expenditure for protection of industry.

SEC. 6. We turn now to a treatment of the fiscal character of protective duties: (1) In the first place, it is clear that the more "protection" the duty gives, the less will be the revenues afforded to the government, and the greater the possible revenues to the subsidised producer.

A high protective tariff yields little revenue.

Absolute protection means the exclusion of the foreign commodity and no revenue to the government. The subsidy that the producer can obtain is determined by the conditions of production; it varies from nothing to the whole amount of the tax according as the cost of production varies above what the cost of the imported commodity would be without the duty. (2) Above a certain point high duties tend to diminish the revenues to the government, and increase the subsidy to the producer, by diminishing the amount of the commodity imported.

The point beyond which the total revenues diminish is ascertainable by a principle similar to that of charging what the traffic will bear.

At what point is the revenue yielded largest?

In practice that point can be ascertained by gradually increasing the duty until it is found that the importation begins to diminish, and stopping the increase of the duty when it is found that the added duty checks more of the importation than the increased duty compensates for. A tariff of customs

The cost of protection is paid by the consumer.

duties arranged throughout on this principle would be a revenue tariff, and if universal, would yield enormous sums.

It would, also, contain many protective features.

The burden of such a tax would be insufferable. No such general tariff has ever been enforced. (3) Protection is given only when the price is raised. The subsidy paid to the producer is paid by the consumers within the country. This part of the tax is never shifted to foreigners and generally remains on the consumer. (4) But that part of the tax which flows into the treasury of the government is not always, although generally, paid by the consumer, whether protection is afforded thereby or not. There are a few rare instances in which the tax that forms a part of the government's revenue is shifted either to the foreigner, *i.e.* the producer, or the speculator, *i.e.* the importer. These instructive instances may be summed up as follows: The consumer escapes that part of the tax which flows into the treasury on purchases of commodities actually imported: (a) When the amount of the commodity produced in the country laying the tax is sufficient in quantity to entirely supply the home market and to fix the price very close to the cost of production, while the foreigner has at the same time so large a supply that he must enter that market to dispose of it. In this case, if any revenue at all accrues to the government, it is clear that it is paid by the foreigner, who is burdened by the whole tax and may lose more, — more, that is, if his entrance into the market still further depresses the price. The home producer gets no subsidy. A

The tax actually collected by the government is not always paid by the consumer.

When the foreigner pays the whole tax.

commonly cited example of this is the case of rye in Germany in good years when the outside crop is also good. (b) When a new tax is laid on goods pro-

*The foreigner
pays the tax
temporarily.*

duced by the aid of a large fixed plant for a limited market which would be lost if the price were raised. As long as the producer is unable to change the nature of the plant, he must pay the tax. An example was found in the iron products from the Rhine districts prepared for the trade as "Sheffield" cutlery. England could in this case tax the foreigner until such time as he could change the character of his product. (c) In the

*The foreigner
pays a part or
all of the tax.*

case of commodities that are used only as the substitutes for something else because cheaper, and which would not, if the price rose higher than that of the commodity for which they are used, be consumed at all. In this case the foreigner pays a part or the whole of the tax when the alternate commodity is cheap. For example, rye in Germany when wheat is cheap, espe-

*The foreigner
pays a part of
the tax.*

cially if at the same time the crop of rye is short. (d) In the case of commodities a large part of whose total consumption is produced in the country, but not enough to absolutely fix the price, which is still above the cost of production. The foreigner in that case may pay part of the tax, since his arrival depresses the price.

*The speculator
pays the tax.*

(e) The speculator regularly pays the tax in those frequently recurring instances when the commodity is massed in warehouses on the

border ready for importation on a rise in the price, and on being imported, at the order of various speculators, in large masses depresses prices again. It is a pretty well-established fact, from the investigations of Cohn and Kandtorowicz, that the speculators on the Exchange as a whole lose more than they gain. This loss is in part the consumer's gain through the relief from taxation.¹

SEC. 7. Customs duties regarded merely as a source of revenue depend upon the same principles exactly as those which underlie excises used for that purpose. The greater revenue is obtained with the least expense from a few simple duties upon important commodities.

Technically, customs duties are of two kinds, according as they are levied upon goods in bulk irrespective of their value, or the contrary. *Specific and ad valorem duties.* This technical distinction is of great importance in determining the incidence of these taxes. Duties levied according to the value of the imported commodities are known as *ad valorem*; those according to weight, bulk, or other unit of measurement are known as *specific*. The latter usually fall most heavily upon the coarser or cheaper grades of commodities. Such a tariff is, therefore, regressive and contrary to the spirit of many con-

¹ See the masterly treatment of the whole of this intricate subject by Lexis, "Handel," in *Schönberg's Handbuch*, 2d ed., Vol. II., XXI., sec. 77; also Conrad, in his *Jahrbuch*, XXXVII.; Cohn, "Zeitgeschäfte und Differenzgeschäfte," in *Hildebrand's Jahrbuch*, VII., p. 388; brought down to date in 1890 by Kandtorowicz.

sumption tax systems, which usually tax luxuries more heavily than other commodities. But the great saving in expense, and the great ease of collecting and administering specific duties, go a long way in recommending them. *Ad valorem* duties demand more machinery of administration, as, for example, the certification of the consul in the place where the goods come from to the correctness of the invoice, a corps of appraisers, and a careful examination or inspection of all incoming goods. Little of this is necessary in the case of specific duties. Specific duties are now retained mainly for simple commodities of uniform value per unit, or for rough groups of articles, whose value is easily ascertained.

The watching of the frontier and the prevention of smuggling is one of the primary difficulties that have to be overcome in the administration of customs duties. Goods of high value and easily portable are not very well adapted to pay such duties, unless they can be obtained only from distant countries and are thus easy of identification. Whenever there is a heavy excise on any commodity there is generally a correspondingly heavy customs duty as well. Sometimes the imported commodity pays both the duty and the excise or a part of the excise.

The political or protective element in customs duties has been gradually retreating in importance, and the fiscal has correspondingly advanced. Stein¹

¹ Vol. II., Part II., p. 377.

makes this the sole law in the history of customs duties. It would be best characterised as an advance of the fiscal interest, leaving the political or protective interests the same as before. The pressing wants of nations, and the fact that federal governments have been well-nigh confined to these taxes, has necessitated this advance.

SEC. 8. We may now look at some examples of customs duties. Those of England are particularly instructive.¹ The term "*consuetudines*," or customs, applied to the duties levied upon imported and exported commodities even before the Magna Charta, bespeaks their antiquity. In the time of the Norman kings, however, trade was insignificant and the duties not very productive. The original duty on wine was one cask from every cargo of between ten and twenty casks, two from twenty or more. What the original duty on wool was is not known. Finally the system settled down to a 5 per cent tax on all imports and exports. Down to 1700 these duties were entirely for revenue purposes and had no intentional protective features. At one time their yield was nearly £1,500,000. The eighteenth century saw a changed policy. Special protective and prohibitive duties were established. This was the policy of the entire century, except during the

¹ See Hall, *History of the Customs Revenue*, and Dowell, *History of Taxation*.

"long peace" of Walpole, 1722-1739. By 1759 the general charges were 25 per cent, while many commodities, like tea, coffee, sugar, wines, and spirits, paid even more. The expenses of the wars which marked the turn of the century led to a general increase of charges on revenue-yielding commodities. Yet with all the many increases in the tax charges there was not a corresponding increase in revenues. In some cases the high duties of the war period exceeded the limit of what the goods would bear. For example, sugar paid duties ranging from 20s. to 39s. per hundred-weight during the first fifteen years of the nineteenth century. But the annual income was least when the duties were highest. Consumption fell off half a million hundredweight under the higher price. It must be noted that this result was obtained in the case of a commodity not produced in the country itself. Salt, also, bore a heavy duty in this period to the lessening of the consumption. Tea, coffee, tobacco, wine, and other foreign products were also subject to revenue duties so high as to be close to, if not beyond, the limit of greatest productivity.

Interesting and instructive is the experience of England with protective duties. Export duties on raw material, or the prohibition of the exportation thereof, as in the case of wool, was originally one of the most prominent features of the English system. From the middle of the seventeenth century down to 1825 the

*England's
protective
duties.*

exportation of home-grown wool was forbidden. Until 1802, however, the importation of wool was free. Then the import duty rose rapidly from 5s. 3d. per hundredweight, in 1802, to 56s. per hundredweight, in 1819. To encourage the production of raw silk, heavy duties were placed upon that commodity in 1765, and not lessened until 1825. Linen manufacture was encouraged by bounties.

The chief battles over the customs duties in England were waged around the "corn-law."¹ Two things among others of minor importance seem to have contributed mainly to the establishment of protective duties on bread-stuffs.² The first was the existence of heavy public burdens upon land, and the desire to compensate land owners and land users therefor. The other was the desire to make England as independent as possible of all foreign nations for her food supply, and to keep even the poorer lands in cultivation. According to the advocates of this policy, protection was needed to enable the proprietors and tenants to buy manufactured products. It was the political power of the proprietors that enabled the policy to be maintained. The various tariffs that prevailed may be conveniently summarised as intended generally to maintain a chosen price, which it was assumed would enable

¹The American student must bear in mind that in England "corn" means wheat, or, in general, bread-stuffs.

²See McCulloch, *Taxation*, p. 206; Wilson, *National Budget*, p. 62 ff.; Levy, *History of British Commerce*, 2d ed., Part II., Chap. 7; Rand, p. 207 ff.

the producer to live, and would not place too heavy a burden on the consumer. Hence the frequent recourse to a sliding scale by which a higher duty was imposed as the price fell. The best example is the scale adopted by Sir Robert Peel (5 and 6 Vict. c. 14), by which the duty was to be 20s. per quarter when the price was 50s. and 51s., and decreased 1s. per quarter for every rise of 1s. in price; so that the duty should only be 1s. per quarter when the price rose to 70s. and over. The idea was, clearly, to maintain, if possible, a price of at least 70s. A similar purpose underlay the earlier prohibition of importation, until the price rose above 80s. per quarter.

Popular agitation, headed by the Anti-Corn Law League, was based upon the hope of cheaper food supplies. It was supported by the rapidly growing manufacturing interests in the expectation that cheaper food would result in a fall in wages. After years of effort it brought about the repeal of the corn laws in 1846. The sympathy aroused by the Irish famine of the same year contributed to this end. Just before the repeal of the corn laws Peel had, in 1842, simplified the whole tariff by eliminating many of the protective features, especially by removing duties on raw material and freeing a number of small articles. As a substitute source of revenue the income tax was restored. Gladstone, in 1860, completed the removal of protective features. Since that time it has

The elimination of the protective features.

been true, in the words of Bastable, that "the English customs system is remarkable for its vigorous adherence to the principle of purely financial duties. All traces of a political aim in the imposition of customs duties have now disappeared." The corn duty was, however, restored as a revenue measure at the time of the Boer War. It lasted but a short time, namely, from April 15, 1902, to July 1, 1903, and during that time yielded £2,448,000.¹

During the fiscal year 1907-1908 the customs yielded £32,500,000 as follows: tobacco, £13,739,000; tea, £5,807,000; coffee, £184,000; cocoa, etc., £287,000; chicory, £47,000; currants, raisins, and other dried fruits, £456,000; sugar, £6,708,000; beer, £23,000; spirits, £4,133,000; wine, £1,177,000.

There are now only about 40 rates in the English customs tariff. In 1875 there were 53, as against 397 in 1859, and 1046 in 1840.

SEC. 9. The difficulty of administering customs duties in the small and scattered areas of the different States of Germany led to the formation of the German customs union (*Zollverein*) in 1833. This union, which at first embraced a population of 25,000,000 and a territory of 80,600 square miles, grew in size and in permanence with the renewal, from time to time, of the treaties which bound together the States composing it, and with the entrance of new States,

*The German
customs
union.*

¹ The so-called "registration" duty, 1869-1870, yielded £1,000,000 during the entire period of its existence.

so that in 1854 it embraced 98,000 square miles and 35,000,000 inhabitants. It was the core of the present German Empire. At the beginning the moderate, mainly revenue, duties of Prussia were adopted. In the tariff of 1865 the rates were lowered and many removed. Duties on grain and on almost all raw materials were removed, and the duties on manufactured goods reduced. The free-trade tendency which accomplished this change lasted until long after the formation of the Empire, indeed down to 1877.

The constitution of the Empire confers upon the imperial legislature the exclusive power to regulate customs. It may levy taxes to any amount upon *The customs of the Empire.* all articles exported or imported, for revenue purposes or for protection or for both. But the imperial legislature cannot tax anything else. Further revenues, if needed, can be raised in the form of an apportioned requisition upon the commonwealths of the Empire. The growing need of the Empire for revenues was accompanied by a wave of protectionist sentiment, so that the increased duties were more and more protective in character. It is true, however, that the revenue features were increased at the same time.

Particularly interesting is the duty on grain, introduced in 1879, and raised several times since then. The rate is now 5 M. per 100 kilograms for wheat and rye, 4 M. for oats, $2\frac{1}{4}$ M. for barley. These duties are in some measure protective in ordinary

seasons. It is frequently found that a part of the revenue which flows into the treasury from this source, especially in extraordinary years, is paid by others than the consumer.¹ Generally, however, the consumers pay the home producers a goodly sum in the shape of higher prices. The operation of these grain duties has been materially modified in recent years by the conclusion of commercial treaties with some of the grain-producing countries. The main revenues from customs duties in the Empire come from coffee, tobacco, wine, and grain.

SEC. 10. France has a highly developed system of customs duties. By the edict of 1664 Colbert attempted to reduce to a single uniform *History of the* scheme all the confused and multifarious *French tariff.* customs charges that had come down from feudal times and were in the hands of many different authorities. The tariff thus established was protective in character and was dictated mainly by the mercantile doctrine. But many provincial duties were left, and as time went on confusion increased. The Revolution swept all the old taxes away, and in 1791 the system which is the basis of the present one was established.

The development since then has been gradual. Prohibitions of imports and exports, so numerous in the tariffs of the ancient monarchy, have now all been removed. Since 1863 the only exceptions to this statement are books that infringe the copyright

¹ See example cited above ; also Cohn, p. 565 ff.

law and munitions of war. To insure the proper registration, for statistical research, of all traffic, there used to be an import charge on all goods of 15 centimes per 100 francs' worth or 50 centimes per 100 kilograms, and an export charge of 25 centimes per 100 kilograms. These have been removed.¹

During the period subsequent to the Revolution, and down to 1814, war measures left no opportunity to test the tariff of 1791. The Restoration established a highly protective system at the instigation of the Chambers. The Second Republic continued the same policy. Napoleon III., finding himself unable to persuade the deputies to change the tariff, removed many of the prohibitive duties by treaties. The first of these treaties, with England in 1860, fixed the maximum *ad valorem* duty on English goods at 30 per cent for the first four years and 25 per cent after that. Other treaties followed, extending similar privileges to other countries. In the spirit of these treaties the tariff itself underwent many amendments, raw products were admitted free, duties on foods were removed or lowered, and the duties protecting the stronger manufactures were lowered. By 1873, that is, after the struggle with Germany

The two was over, and after the revenue system
tariffs. had been rearranged to meet the tremendous burden which was the consequence of the war,

¹ On the whole subject see Levasseur, "Recent Commercial Policy of France," *Journal of Political Economy*, Vol. I., No. 1, December, 1892.

France had two distinct tariffs. First, the general tariff built upon the law of 1791 amended many times. Second, a conventional tariff based upon treaties. Since these treaties generally contained the clause granting each nation the same privileges as the most favoured, this tariff was more uniform than the method of construction would lead one to expect. In 1881 the general tariff was pretty thoroughly revised so as to approach the treaty tariff. Manufactures were slightly protected. With this as a starting-point new treaties were made.

One of the most remarkable reforms that any tariff has ever undergone was accomplished in 1892. This was the passage of two tariffs in a *The tariff reform of 1892.* single law. There was first a general tariff or maximum which was to be levied on goods from all countries not obtaining special privileges by treaties. Second, a minimum tariff marking the lower limit to which the concessions might go. The latter was to be applied to the native products of those countries which grant French products reciprocal privileges. Both of these tariffs were protective. There are over 700 items in the maximum tariff, but the number on which concessions could be made was considerably less.

SEC. 11. The tariff history of the United States has been written many times.¹ Its effects have been explained in many different ways. Not one of the

¹ Sumner, *History of Protection in the United States*; Taussig, *Tariff History of the United States*.

many histories is clearer and more impartial than the short statement by Professors Seligman and R. Mayo Smith, printed (in English) in the publications of the *Verein für Socialpolitik*, 1892 (Vol. XLIX., Part 1). Nothing but the barest outlines can be attempted here.

The colonial policy of England prohibited the exportation of the more important commodities, the "enumerated" articles, to any country but England. Importation was to take place only from British ships. As was seen in the chapter on Protective Expenditure, bounties were paid to encourage agricultural products. The only import duty in the colonies was that imposed in 1773 on rum, molasses, and sugar from other than British colonies.

After the War of Independence there was a movement to protect the new industries which had sprung up. As Congress did not, until the adoption of the new constitution in 1789, have the power to collect duties, the commonwealths tried to afford the desired protection. There is naught but confusion in these efforts, all of which, however, came to an end when the commonwealths were forbidden to levy customs duties.

The tariff was the sole source of tax revenue which the new federal government had. It was, consequently, largely utilised from the first. Down to the close of the War of 1812 the tariffs were, in effect, if not in intention, revenue and not protective tariffs. The rates were generally

*Tariff history
of the United
States.*

*The beginning
of the tariff.*

low, except on purely revenue articles like sugar, tea, coffee, and wine. The Orders in Council, the Berlin and Milan decrees, on the east side of the Atlantic, and the Embargo and Non-Intercourse acts, on the west side, followed by the War of 1812, gave absolute protection to American industries and seriously lessened the growth of the customs revenue of the government for a period of seven years. It is not surprising, therefore, to find the new industries which had been forced into existence during that time calling loudly for protection after the peace. A strong protectionist sentiment arose which initiated a policy that had scarcely more than a temporary setback from 1816 to 1895.

That policy was to combine high protective duties with important revenue duties. The main arguments advanced for and against the policy of protection have been stated under Expenditure. The industries protected were the textiles, cotton and wool, and iron. Among the revenue duties may be named those on tea, coffee, and wine, and perhaps those on sugar and tobacco. The first period of the protective policy passed the highwater mark in 1828.

*The beginning
of the protec-
tive policy.*

The only important setback which the policy sustained before the recent tariffs was in the so-called free-trade period from 1846 to 1860. The act of 1846 was heralded as a tariff for revenue only, but it was still highly protective. The duties on the classified

*The so-called
free-trade
period.*

commodities ranged from 5 per cent to 100 per cent ; the last on spirits. Some purely revenue duties were removed entirely, as, for example, the duty on tea and coffee. The protected textile industries retained their duties for the most part ; woollens 20 to 30 per cent, cottons the same, iron 30 per cent. All the duties were made *ad valorem*, a change which involved an increase in the cost of administration. A more substantial reduction was made in 1857.

The crisis of 1857 resulted in a serious decline in the revenues, and just before the Civil War broke out, Congress passed the so-called Morrill tariff, March 2, 1861. This tariff increased the protective duties, especially on iron and woollens. From the technical side this act made two changes of note. First, specific duties were again restored ; second, the system of so-called compensating duties was initiated. This second feature, which afterwards received a very broad application, can best be made clear by an illustration. The Morrill tariff increased the duty on raw wool. To compensate the manufacturers for this, a specific duty, supposed to represent the duty on raw materials, was placed on manufactures of wool, together with an *ad valorem* duty for protection.

Immediately after the passage of the Morrill act the war broke out. Under the pressure of the need for revenues Congress passed a long series of acts increasing the duties on purely revenue articles, putting duties upon articles

hitherto free, and raising as compensation the protective duties. The idea of giving compensatory duties was extended to cover the burden of internal taxes also. Thus the manufacturers were, in 1864, given special compensatory duties to offset the heavy internal taxes. This remarkable protectionist measure, embodied in the act of 1864, was rushed through Congress with only one day's discussion in each house. It represents the highest limit ever reached. Nearly 1500 articles were enumerated; the average rate was close to 50 per cent. It shows the effect of three different forces: there was (1) the desire to increase the revenues, (2) the feeling that the manufacturer had a good claim for compensation for the high taxes in general, (3) the mad scramble to gain all that could be gained from this class of legislation.

This act afterward received a number of amendments to meet the changes made in the other parts of the revenue system, but the character of the tariff was not materially changed until 1883. One of the most interesting changes, technically, was the fixing, in 1866, of the method of ascertaining the value upon which the duty was laid. It was provided that the value should be determined by adding to the value, at the place of shipment, the cost of transportation, packing, commission, warehousing, and other charges which fell upon the goods before their arrival.

The protection policy thus extended gave strength to vested interests which thereafter supported that

policy. The only changes of note down to 1894 are the attempted reforms of 1870, 1873, and 1883, and the McKinley tariff of 1890, which reduced the income by removing the duties on purely revenue articles and on very strong, self-sustaining industries, but increased the protective features.

In 1894 came a change that at first appeared to be very important. The McKinley bill of 1890 had become practically the platform of the Republican party, and the Democratic party went into power pledged to the reduction of protection. They proceeded slowly to the fulfilment of these pledges. The famous Wilson bill was reported December 19, 1893, and became a law August 27, 1894, without the approval of the Democratic President. It failed of his approval because of the objectionable features introduced in the Senate. Two things prevented the change from being sweeping. The first was the power of the vested interests in the protected industries. Every sort of pressure, short of illegal, was brought to bear in favour of the existing system. The second was the patent danger of too sudden a decrease. Sweeping reform would ruin industries and create a depression.

The reduced tariff was not destined to remain long in force. Within three years, that is, in 1897, there was a deficit in the treasury, which gave an excuse for new tariff legislation. By this time the protectionists had rallied and were again in power. Congress was called together in special

session and passed the so-called Dingley tariff, as a strict party measure. This tariff restored most of the protective features that had been removed in 1894. Protection was again granted to wool as a raw material, and compensatory duties were placed on manufactures of wool. In some respects the wool and woollen schedule was made higher than ever before. Hides, which had been on the free list ever since 1872, were given a protective duty of 15 per cent *ad valorem*, while, to quiet the protests of the shoemakers, manufacturers of leather received a compensatory duty that fully made up for the increased cost of the raw material. On cotton goods, however, the duties were slightly reduced, although not all along the line. Silk and linen received a rather substantial advance. The iron schedule was not materially changed from the condition in which it was left by the McKinley bill. The greatest struggle was waged around the sugar tariff. The duty placed on raw sugar in the Wilson bill was retained and slightly increased, while the refiners received a differential that afforded them very handsome protection. On the whole the Dingley tariff raised the protective wall higher than ever.

Having reached this stage, the protective system rested for twelve years. During this time there developed, very slowly, a sentiment for tariff reform. The protectionists yielded a little to this sentiment, and won the privilege of having the tariff "revised by its friends." In April, 1909,

Congress was again assembled in special session to "provide revenues to meet a deficit" and to consider a bill known as the Payne bill, which had been prepared by a committee of Republicans with a view to propitiating the sentiment in favour of tariff reduction. Of this bill the committee said: "While it makes a number of reductions in the rates on industries that can admittedly stand alone, it raises the rates on certain industries, that in the opinion of the committee need more protection." This bill was heavily amended in the Senate where the protectionists were strongly intrenched. It was again amended under pressure from the Republican President who interpreted the election promises of his party as favouring a revision downward. When the President signed the bill, August 5, 1909, he summarised it as follows: "This is not a perfect tariff bill, nor a complete compliance with the promises made, strictly interpreted, but fulfilment, free from criticism in respect to a subject-matter involving many schedules and thousands of articles could not be expected. It suffices to say that except with regard to whiskey, liquors, and wines, and in regard to silks and to some high classes of cottons, all of which may be treated as luxuries and proper subjects of a revenue tariff, there have been very few increases in rates. There have been a great number of real decreases in rates and they constitute a sufficient amount to justify the statement that this bill is a substantial downward revision and a reduction of excessive rates." One of the

interesting features of the bill is the provision of two tariffs in one, which is popularly supposed to be a partial adoption of the idea of the French maximum and minimum tariff above referred to. But there is a fundamental difference, for if the French system is properly described as a "maximum-minimum tariff," that proposed for the United States is a "minimum-maximum tariff." That is, the French system applies the maximum as a norm, from which deductions may be made for favours received. But the American system applies the minimum as a norm, to which additions may be made by way of reprisal in the case of those countries whose tariff policy does not please the United States. In other words, the French system is one of reciprocity, the proposed American system one of retaliation. Possibly no other position can be adopted by the United States. She has steadfastly maintained that the "most favoured nation" clause in her commercial treaties cannot be construed as applying to the tariff, and many of the duties in the tariffs of European nations are directed specifically against the trade of the United States by way of retaliation for her own high duties. The bill is not generally regarded as a final settlement of the tariff question. It contains a provision for the appointment of expert agents to assist the President in administering the maximum-minimum clause and many hope that this will lead to the collection of information which will render a systematic and unprejudiced revision possible.

CHAPTER VIII

PROPERTY TAXES

PART 1. *The General Property Tax, with Special Reference to United States*

SECTION 1. The general property tax may be defined as a tax in which the base is the entire amount of the property, real and personal, owned by the taxpayer. This tax is old and is a favourite tax for local purposes. The general property tax can be studied to the best advantage in the United States,

The general property tax exemplified in the United States. where it is used more extensively, perhaps, than in any other country, and where it is the main source of revenue for very important parts of the government.

It is also used in Switzerland as the main source of revenue for some of the component parts of the federal State. In Prussia, Holland, and some other countries it is used to supplement other taxes, but when so used, it takes on a different character. The federal government in the United States does not levy any tax on property in general. If under the constitutional provision, which requires that direct taxes shall be apportioned among the states in proportion to population, the federal government should levy a tax, that tax would presumably be apportioned among the

people by most of the states in accord with their own laws, and collected as their own state taxes are collected.

We need to see first the relation in which this tax stands to the other taxes in the system of state and local taxation.

The individual states, the cities, and the other local divisions of government in the United States derive their revenues from a considerable number of sources.

They each use some or all of the following taxes : (1) the general property tax ; (2) the poll tax, payable either in money or in services or in both ; (3) taxes on selected kinds of business ; (4) taxes on certain ways of conducting business, as

*The position
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the corporate form ; (5) inheritance taxes, and (6), in a few instances, income taxes. They also use license taxes or fees for permits which are distinguished from taxes proper by the fact that regulation rather than revenue is the more important consideration. They also receive other fees of many sorts, mostly small, for special services to individuals, recording of documents, and the like. Streets, sewers, and other similar public improvements are mostly constructed from the proceeds of special assessments on the property immediately benefited. The cities, especially, not all, but many of them, and to a very small extent the states also, receive revenue from waterworks, gas and electric works, street railways, canals, and other public service enterprises and to a very small extent

from industrial and commercial enterprises. A few of the states receive revenue from the sale or use of public lands. There are in addition a number of fines and penalties for various infractions of law.

Among all of these sources of revenue the general property tax stands preëminent. It is the structural iron which holds the building together. It is

The preëminence of the general property tax. the largest single source of revenue and is universally regarded as preëminently *the tax* for all purposes. There is no

state in the Union in which this tax does not exist at least as a tax for local purposes, although there are six states in which it is not used to supply revenue for the state or central government. Without a single important exception, it is used in every city, in every town or its counterpart in local government, in every district, be it a road district, school district, drainage or irrigation district, or a district organised for some other purpose. The few exceptions are insignificant, and are in each case due to conditions clearly peculiar.

The general property tax of the United States was, in its original conception, a direct personal tax for local purposes. It was a tax on persons, natural or

The general property tax originally a personal tax. corporate, in proportion to all their property. The only exemptions were originally persons, usually corporate, like municipal corporations, schools, colleges, and churches which were regarded as performing some public or quasi-public functions. Sometimes natural persons,

like ministers of the gospel, paupers, invalids, or veterans of war, were exempt from pious, religious, charitable, or patriotic motives. The present statutes still show marked traces of the personal character of this tax as originally conceived. As an illustration of the older conception we may cite Vermont, where every person was "rated" or "listed" for his poll, his property, and all his "faculties." In all the older laws the "person" came first, and his estate was the attribute by which the amount of his tax was measured.

It was a local tax intended primarily for the apportionment of neighbourhood charges among neighbours. The functions of government were at first exercised mainly by the local divisions. Even as late as 1840, when the functions and activities of the state or central governments had reached the first stage in their development, this tax was used to a very limited extent only, for supplying revenue for other than strictly local purposes. By slow degrees the larger unit of government, the commonwealth, began to draw upon this source by way of rates additional to the local taxes. Strangely enough, these added rates rarely, if ever, took the form of a surtax so common, for example, in Spanish taxation, nor did the surtax conception enter American financial thought anywhere until after 1890. Yet the effect of these additional tax rates is distinctly the same as that of the surtax.

By degrees, also, the strictly personal conception of

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property tax
as a local tax.*

the tax has been modified, and it has steadily become more and more of an objective tax, or a real tax. This change has come about first through customs operating with the force of law, and is not even now so apparent in the statutes as it is in the actual administration. With several notable exceptions, of which New York is a conspicuous example, the personal declaration of the taxpayer may still be required and is more or less regularly exacted. But even where this form is still retained, property, even real estate, may be taxed in the name of "unknown owners." As commonly conceived by legislator, administrator, and taxpayer alike, the general property tax, as it stands to-day, is a tax on all property, irrespective of ownership, within the territory of the taxing authority, except such as may be expressly exempted on account of its use for a public or quasi-public purpose or out of consideration for what is regarded as a desirable public policy. As an illustration of this, we may quote the phrase most widely used as the introductory sentence of the revenue laws of the various states: "All property, real and personal, within this state, not specially exempt, shall be taxed in proportion to its value." Yet traces of the older conception of a personal tax remain, often inconsistent and illogical, and giving rise to confusion of thought and practice.

SEC. 2. Although this venerable tax, which dates from soon after the establishment of the various

colonies on the continent of America, has been developed in each of the several states from a common origin as to principles and ideas and by very similar social, political, and economic forces, yet there are variations from state to state, and from one part of the country to another, which are by no means insignificant. Some of them are, in fact, so important that a failure to recognise them leads to a serious confusion of thought. It is this divergence, in one state or another, from the general type which makes it so difficult to explain briefly the nature of American tax problems. These differences concern in some degree the kinds and classes of property subject to the tax. But they concern in far greater measure the forms and methods of administration, and as it is on the administrative side that the greatest evils have been apparent, these may be considered as the more important.

Although, as just suggested, the constitutional provisions, the statutes, the ordinances, and the equally potent controlling practices, customs, and traditions vary from state to state, and although no two of them are exactly alike, it would nevertheless be an exaggeration to say that there are fifty-one different varieties of the general property tax in the United States. Such a statement would lay too much emphasis on minor details. There are, however, several more or less distinct types. Some of the differentiating characteristics of these types are the result of the differences in the framework of the

government,¹ others arise from differences in the social and industrial development.

In attempting to describe these types in a brief space we inevitably incur all the dangers of any broad generalisation. It should be understood that in many cases the types interblend; also, that for clearness' sake we shall select examples of the extreme forms of each type.²

Among the oldest types is that which we may call the New England. This extends wherever the New England township form of local government extends, and even where the township system is modified by a superimposed county system. That is, in all the territory north of the Ohio River and of its line extended as far westward as the Rocky Mountains. It is that type of the general property tax. *The New England type of general property tax.* property tax which is the historical outgrowth of the well-known and famous "township" system of local government. It differs from the other types not so much by reason of any difference in the underlying conception of who and what is taxable, as it does in its administrative features. In general, the administrative or tax district is small,

¹ Any reader not familiar with the various forms of local government in the United States will find enlightenment in Fiske, *Civil Government in the United States*; Bryce, *American Commonwealth*; and Hinsdale, *American Government*.

² The reader who wishes to delve into the multitudinous details and variations is referred to the present writer's contribution to the Census Volume on Wealth, Debt, and Taxation. Special Report, 12th Census, 1907.

very small. In the "West" it is a township, six miles square; in older settled states it may be even smaller, it may be a city ward. Sometimes this district contains only a few hundred inhabitants, rarely over five thousand, and the number of taxpayers is, of course, very much less, perhaps a fifth or an eighth of the population. Consequently there may be considerable common knowledge of each other's affairs among the taxpayers, at least outside the cities, and the assessors may be assumed to have some knowledge of the property which they are to assess and of the value thereof. The assessors, for there are often several in one township, are elected for short terms, one year or two years, and in some cases perform their official functions without interrupting their ordinary vocations. Their work can usually be performed in a few weeks. In short, the administration is democratic, springing from the taxpayers themselves and ever under their control.

There are many variations of this type. There are some in which there is no central control at all, or so little that it has no influence, and others in which the administration is quite highly centralised. Between these two extremes are many degrees. We have space only for two examples, one at each extreme, Rhode Island and Indiana. Rhode Island affords an excellent illustration, possibly the best, of a highly decentralised system. Rhode Island, as has often been pointed out, is, as a state, a sort of federation of small

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land type.*

towns, each retaining a degree of autonomy and independence greater than such units enjoy anywhere else in the country. Here the state has very few functions to perform, and the "county" is a mere grouping of towns into court districts, a geographical rather than a political conception. The tax for state and county purposes, the county expenses being met from the state levy, is less than 10 per cent of the total amount raised by means of the general property tax. Consequently there is no fiscal reason, or at least not a strong one, for central supervision. The state levy was until very recently apportioned roughly among the towns at long and irregular intervals, of about sixteen years each, by a sort of contractual agreement between the towns made through their representatives in the legislature and taking the form of law. The administration of the tax is, therefore, almost purely a matter of local concern, although provided for by a general statute. Each of the towns, many of which contain less than two thousand inhabitants, elects each year in town meeting not less than three nor more than seven assessors, also a tax collector. The assessors are all-powerful, their action nearly final. There is no provision for review or for equalisation between individuals. The only recourse an aggrieved taxpayer has is to take the matter into the courts. Not even the date when the assessment is to be made and to which it applies is fixed for the state at large, each town selecting these to suit itself. Such is the extreme of the

democratic or New England type of the general property tax.

In most of the other states having the same general type of this tax there are local boards of review, usually consisting of the local council, "trustees," with power to revise the assessments made by the assessor. In *The beginnings of central control.* still others, owing primarily to the greater importance of the central or state functions, and the consequently larger proportional amount of state taxes to be apportioned, there is more central control. The cruder form of this central control is a state board of equalisation with limited power to review the work of the local assessors. Such boards do not, as a rule, change individual assessments, but by making a nominal valuation for each township or tax district as a whole determine the amount which each town shall pay to the state. But that amount is apportioned among the individual taxpayers on the basis of the original assessment. Such boards as these are virtually apportioning boards only. A fine example of this is afforded by Michigan, where an apportionment of state taxes is made only once in five years, and each town adds to its tax rate enough to raise its quota of the state tax. There is thus no general state tax rate.

From this crude form of centralisation, which scarcely affects the local or decentralised character of the tax administration we *The Indiana system of central control.* pass, from state to state, through varying degrees of centralisation until we come to those like

Indiana. That state has the old general property tax almost pure and undefiled in principle and theory, and yet has a very powerful central controlling board. The original assessment is still made by a multitude of local assessors elected and acting in the small townships. But these assessors are supervised and directed by county assessors, one for each county, who are assisted by other officers and act as the agents or representatives of the central or state board. By conferences, instruction, and sharp supervision, backed by the right to discharge assessors, the central board exercises a very effective control reaching down into each township.

There are two controlling reasons for this development of central supervision. The first is that the proportionate amount of state and county taxes to be apportioned is greater. Thus in Rhode Island, as we have seen, the state tax, which includes county taxes, is less than ten per cent of the total tax, while in Indiana the state and county taxes amount to nearly half of the total taxes on property. Clearly, then, any inequalities in the valuations between the different towns become at once of great importance. If, for example, a given town has property which at the average rate of valuation for the state would be assessed at \$200,000 and would usually pay, say, \$2000 in town taxes and \$2000 in state taxes, should make its valuation only \$100,000, it would pay in town taxes still \$2000, but would pay in state taxes only \$1000,

*The reasons
for central
control.*

throwing \$1000 unjustly on other towns. The other controlling reason for greater centralisation is the existence of railroads and other great public service corporations whose property lies in many townships. The local assessor may know all about the value of farm lands in his little town, and how much a cow or a hog is worth, but he cannot possibly know how much six miles of railway track, part, perhaps, of a great transcontinental railway system, are worth. Such properties can only be valued as part of a whole. Hence, the application of the so-called "unit rule" necessitates a state board. This reason for the centralisation of the administration of the general property tax exists, also, in states not having the New England type of this tax, but it is far more potent in states where that type exists because of the extreme smallness of the assessment district.

A second type of the general property tax is found in the Southern states, and may, for that reason, be called the Southern type. In general, it is found in the territory south of the Ohio River and as far west as Louisiana. It is almost everywhere accompanied by an extensive system of business license taxes which fill in certain gaps in the general property tax, and hence modify the classes of property to be included. On its administrative side it has been determined by the county system of local government which exists in those states where it is in force. The county being a very much larger unit of local government than

*The Southern
type of the gen-
eral property
tax.*

the township, both in population and territorial area, its government is necessarily more representative and the type of property tax developed is less democratic. The county performs all the functions of local government, outside of the cities which are usually separately incorporated. The county revenues collected from the property tax are in most cases equalled or exceeded by those collected for the state, a condition almost the reverse of that in New England. From the beginning the state or central government loomed larger and had more functions to perform in the South than in the North. Ignoring, for purposes of brevity, the differences between individual states, we may venture to generalise as follows: Under the general supervision of the county court, which has administrative as well as purely judicial functions, the assessor or a small board of assessors makes the valuation of property. As this officer cannot, in the nature of things, know many of the taxpayers whose property he is to value, nor much about values in portions of the county remote from his home, his duties are far more difficult than those of the town assessors in the North and very different in character. Personal declaration by the taxpayer is required, at least by law, and, in general, more respect is assumed to be paid to the values declared by him. Penalties for failure to make a declaration are more severe and more often enforced. The diligence of the assessor is stimulated by commissions, it being customary to compensate him by a

percentage of the taxes levied. Nevertheless considerable property escapes and it is not uncommon to find so-called "back tax commissions" or other officers authorised to assess property not placed on the rolls by the assessors. These commissions are more nearly a part of the regular machinery of government and quite unlike the guerilla or private "inquisitors" of Ohio, to which, as an anomaly, much attention has been devoted.¹ There is also a more pronounced tendency in these states to use the general machinery of government for the levy and collection of this tax, and not to create a special and entirely separate set of officers. Thus the sheriff or the treasurer is often ex-officio tax collector. State supervisory boards are usually composed of ex-officio officers of the state, such as the governor, the auditor, and the treasurer, or the attorney-general, and property of a general character like the railroads is assessed by them. Everywhere else in the country the rate is always determined by apportionment, but in many Southern states a proportional (percentage) rate is fixed by statute and changed only at comparatively long intervals.

The third and last type is the Pacific coast type. This prevails in the states on and west of the Rocky Mountains, and in a modified form in Texas. Although, like the other types, it takes on various forms, yet it is rather more uniform than the other two, and this in spite of the tendency of the people of this part of the

The Pacific coast type of general property tax.

¹ Carver, *Tax Inquisitors in Ohio*.

country to experiment with weird, fantastic, and evanescent theories. This type resembles the Southern type more than the New England type. In fact, the State of Missouri was one of the acknowledged sources from which this type was drawn. It differs from the Southern type more in spirit and traditions than in outward form. The county is here an administrative district of the state government. But the county has less autonomy than in the South, most of its activities being directed by general statutes under the supervision of state officers or bureaus. In New England and in the South authority flows to a certain extent from the local units to the state, in the far West it flows only from the state down to the local units. The state's share of the general property tax is usually about one-third of the whole, including what the state raises for the purpose of equalising the expense of maintaining the school system, which is paid over to the counties for expending, but under general laws. The assessment is made by a county assessor elected for a long term, usually of four years. He is assisted, usually, by many deputies and may assign them districts. Personal declarations by the taxpayers are required by law, but very irregularly enforced. The county administrative board acts as a board of review or "equalisation" as between individuals. There is always, in this type, a state board of equalisation whose functions, however, differ from those exercised by boards of a similar name in the states of the East

and of the Middle West. As has been stated above, those Eastern boards usually make a nominal valuation for the purpose of apportioning the state taxes, and the "state tax rate" resulting may differ in every town, because each town in assuming its allotted quota of state taxes again apportions it on the basis of its own valuations. That is, in the New England type the valuations placed against individual properties are not changed by state board action. In the Western type, if the state board of equalisation decides that it is necessary to raise the valuation in a given county, say, 10 per cent, that 10 per cent is added to each individual assessment on the rolls, and the state rate is the same for every county and every taxpayer. The county "rate" might, consequently, be reduced by such action. Property of a general character like railroads is assessed by a central or state board, usually by the state board of equalisation.

In thus marking out and attempting to describe briefly the three main types of the general property tax on its administrative side in the United States the writer is fully aware *The dangers of this classification.* that he is treading on new ground. He is also keenly conscious that his broad generalisations are dangerous. It may well be that he should have made a fourth group of states like Michigan, Minnesota, Wisconsin, and Ohio, which present many peculiarities. It may be possible that the differences noted are not the most distinctive that

might have been selected. His purpose was, however, to point out that there is not "a" general property tax in the United States, but fifty-one different property taxes, which fall into three or four general groups. Since it is the administrative side of this tax which breaks down and, as we have seen, since there are many different types of this tax, it follows that there is no universal remedy for the existing evils.

SEC. 3. Passing now from the administrative features, let us turn to the content, the property subject to the tax. The statutes quite generally

*The property
subject to this
tax.*

define the locus of the taxable property, the time at which its value and amount shall be taken, and the kinds and character of the property to be included. There has been no particular difficulty so far as real estate is concerned with the place concept, it is real estate within the town, or the county, or the state that is taxable irrespective of the residence of the owner. But when it comes to personal property, especially to intangible personal property, there has been and still is much trouble, and no clear principle of interstate comity has yet emerged. The original theory was, as we have seen, that this tax was a personal tax, and that theory very naturally adopted the legal theory that personal property takes the situs of its owner. But, in general,

*The situs of
property.*

the practice now is to tax personal property where found, if found at all, and the residence of the owner has little significance. A

notable example of the uncertainty of ideas on this subject was afforded when, a few years ago, the state of Vermont expressly exempted all personal property outside the state belonging to residents. Although it was generally assumed that this was done from the alleged unworthy motive of tempting rich New Yorkers to take up a nominal residence in Vermont and thus evade taxation in New York, whose laws make the situs of personalty follow the owner, yet this action merely legalised what has become a very general practice.

The difficulty of determining the situs of personal property is the reason why the attempt to tax stocks and bonds to the owner has been practically abandoned, and in its place it has become customary to tax the property represented by such securities to the corporations, and to ignore the stockholder.

Many anomalies have arisen from this conflict of the theory that the property tax is a personal tax with the fact and practice that it has become a real tax. A very pretty illustration of this is afforded in the case of national banks. It will be recalled that the national banks were established at the time of the Civil War to aid in the sale of the federal bonds, and that to induce the national banks to hold these bonds, those banks were allowed to issue notes secured by the bonds. These national bank-notes came into competition with notes issued by banks chartered by the states. To drive the state bank-notes out of the

*The situs of
personal
property as
illustrated by
bank stock.*

way and to thus make room for the national bank-notes, Congress imposed a tax of 10 per cent on all bank-notes except those of national banks. It had long before been decided by the courts that the states could not tax a federal bank except by express grant of Congress. It was feared that the states, if allowed to tax national banks at all, might retaliate by prohibitive or discriminating taxes. Hence Congress did not, in the first act, convey to the states the power to tax these banks. Later, however, it relented and prescribed a method, and one method only, by which the states should tax national banks. In this federal statute permitting the taxation of national banks we find embodied the prevailing theory and practice of the property tax of that period. The statute says, in substance, that the shares of stock in national banks must be assessed to the stockholder, not to the bank, although the bank may be the agent of the stockholder in paying the tax, also that the shares must not be taxed at a higher rate than is imposed on any other like moneyed capital. Then to prevent double taxation which might have arisen where the stockholder resided in a different state or town from that in which the bank was located, Congress defined the situs of the stock as in the place where the bank was located.

It is hard to trace the origin of a practice which may have sprung spontaneously in many different places from similar conditions which had to be met. But one cannot but be impressed by a reading of the

statutes, and by the frequency with which the phraseology of the federal law is repeated therein, with the idea that this law has had a great deal to do with destroying the theory of personal situs. On the other hand, it has certainly not checked in the least (except so far as the banks alone are concerned) the very general tendency to regard a corporation as an artificial person and to levy the taxes on its property without reference to the stockholders.

The time element, the date to which the assessment refers, is usually defined so as to work the practical exemption of the current products of land. Thus for the most part the assessment is made as of some day in the winter or spring, before the crops of the year have been planted and long after the crops of the year previous have been sold and taken to market, at a time, that is, when barns and warehouses are empty. This strikingly illustrates the prevailing American conception that the property tax is a tax on capital, not on income or revenue. With a sort of grim humour "All Fools' Day" is often chosen as tax day. Even in those states, mostly among those having the Southern type of this tax, which make the day to which the assessment refers fall in the autumn, the crops and produce of the year are usually expressly exempted by law.

The property included in the base of this tax is most commonly defined as "all property, real and personal, in the state not specifically exempt." The

The date to which the assessment refers.

exemptions will be discussed below. The terms "real and personal property" are most commonly taken in their ordinary common law meaning. But this is by no means the universal rule. In many cases certain items are arbitrarily defined "for purposes of taxation" as real or as personal property. Ordinarily, land and the legally immovable physical improvements thereon are real estate. Certain rights, however, attaching to land, mortgages secured on land, and franchises over lands are arbitrarily called real estate or personal property for purposes of taxation, irrespective of their common law character. As these arbitrary definitions are not uniform from state to state, they give rise to considerable confusion. Sometimes even the following of the common law principle makes curious shifting. One of the most striking illustrations of this is the classification of possessory claims to government land and of the improvements upon it as the personal property of the settler thereon during the five years that he is acquiring his title, and before the government patent has been issued. The census of 1890 published tables and charts which made it appear that the then "new" State of Montana had a remarkably high proportion of personal property and comparatively little real estate. This was due in large part to the above classification. The arbitrary nature of these definitions vitiates almost all direct comparisons of the statistics of assessments between different states.

*The terms
"real estate"
and "personal
estate."*

It occasionally happens that for tax administrative reasons or to avoid special difficulties arising from some peculiarity of the law, very illogically arbitrary definitions are made. *Arbitrary definitions.*

Thus telegraph poles and lines are defined in one state as personal property, a device intended merely to give the assessor an extra commission; again, in New York special franchises or the right to use the public streets are defined as real estate. The reason for this latter definition is that in that state each taxpayer is allowed to deduct the amount of his debts from the entire amount of his personal property, and under that law, if franchises were defined as personal property, the corporations owning them would deduct their bonded indebtedness, leaving nothing taxable on the franchise.

Occasionally certain items of income are defined as property for purposes of taxation. These instances are usually of receipts, like those from ships plying in foreign water, or insurance premiums, or brokers' commissions, which are not represented by any taxable capital in the state. This is a survival of the old personal theory of the property tax. *Income defined as property.*

The classes of personal property taxable and actually taxed, at least to a limited extent, are usually household and office furnishings, stocks of goods in shops and warehouses, farm tools, machinery, and live stock. Other forms of personal property generally taxable according to law, but rarely taxed, are

money and credits. The moot questions in regard to the taxation of the latter will be discussed below.

SEC. 4. Property exempt from taxation comprises in the first place all public property, also greenbacks and federal bonds exempt by federal law.

Property exempt from taxation. The only exception here is that in a few states public property may be included

when the apportionment of state taxes is made to towns or other assessment districts. Next in general extent come exemptions granted from religious, pious, charitable, or benevolent reasons, such as churches, cemeteries, asylums, and homes for the aged, the infirm, and widows. The breadth and extent of these exemptions varies considerably from state to state, but even in the most meagre cases includes all church buildings and cemeteries. An interesting extension of this idea is the exemption in many states of the secret societies, like the Masons and Odd Fellows, on the ground of their charities. Another very general class of exemptions comprises those for educational purposes, such as schools, colleges, and the like, usually only those endowed, also public libraries, and literary, scientific, and philosophical societies. A smaller group is composed of associations like agricultural societies, volunteer fire companies, and others doing some work assumed to be of a public character. Lastly, there are many miscellaneous exemptions granted for social or economic reasons or for reasons relating to the fiscal administration; among these are limited amounts of certain classes of personal

property, as a few hundred dollars' worth of household furniture, tools of mechanics and farmers, a limited amount of land, machinery, etc., for promoting new industries for a limited period of time. But there is little uniformity among the various states with reference to this group of exemptions.

In general it may be said of the exemptions granted that while they have, of course, been granted only to those who had sufficient political influence to secure them, they do not in any but a very few exceptional cases represent an abuse of political power. The motives were in general altruistic or for the public weal. It is, furthermore, a thoroughly well-established principle of fiscal law that, whenever, and in so far as, any such property yields any private profit, it loses its exemption.

SEC. 5. The assessment roll, or list of taxpayers with their taxable property, is usually made up annually and does not assume the form of a fixed cadastre in any of the states, although in some states it approaches that form slightly. The original conception of the tax, as a personal tax, is the *The assessment roll.* chief reason why the roll usually begins with the taxpayer and not with the property, and the consequent frequency of assessment prevents the roll from attaining a permanent form. In the case of real estate, however, there is here and there a provision which contains the possible germ of a cadastral system. In a few states real estate is revalued only once in four years, but alterations and new improve-

ments are assessed annually. In some states the county surveyor provides maps and block books which the assessor uses as the basis of his work. But even in those states there is little permanence imparted to the roll by this practice. Two reasons for the absence of a cadastral system, especially in the more recently settled states and in those parts of the country which are growing rapidly in population, is the constant and frequent change in ownership of land and the rapid fluctuation in land values.

The criterion of value for purposes of taxation is always the selling value, and rarely the rental value.¹

The criterion of values. The reader should remember that there is practically no tenant class in the United States, that agricultural land is for the most part cultivated by its owners, or by tenants who expect to become landowners. The annual value of the use of land is a conception rarely used in business. It is the capital value or selling value that is almost always referred to and used. Lands change hands with considerable frequency, and with great ease and freedom. How much land is worth per acre in the country and per square, or per front, foot in the cities at purchase is usually a better-known fact than rental values. While admittedly the value of land depends on the product, yet rental values, when determined, are usually computed on the basis of a percentage of the capital

¹ Delaware and New Jersey and parts of Maryland and Pennsylvania offer the necessary exceptions to prove the rule. In these old states rentals are considered.

values rather than of the product. Assessors in making up their rolls depend upon prices paid when transfers are made, or upon appraisements, for determining the value of land, and rarely, if ever, seek any information as to rentals. This is equally true of city real estate and of farm lands. In the same way boards of equalisation in attempting to check up the work of assessors investigate selling prices, and not rentals. In fact, the leasing of land is so rare, and usually occurs under such peculiar circumstances, that rentals never afford a satisfactory basis of valuation. According to the United States Census Bureau, only 35 per cent of the farms of the country are cultivated by tenants, but among these rented "farms" are many truck farms, dairies, nursery gardens, and florists' gardens in the vicinity of cities, which are more often rented than is agricultural land proper. Another reason why rental values are not used for taxation purposes is that in many states there are large tracts of land not under cultivation. Less than 50 per cent of all land in the United States is "improved"; that is, under cultivation, and less than three-fourths of that actually in farms is "improved." Yet the unimproved, unused land has a selling value in the market, and is taxable. In the same category fall the unimproved city lots, held for speculation.

The use of the selling value, or a capital concept, instead of the rental value, introduces an element of uncertainty into the assessment or valuation of land

for purposes of taxation. A great deal is left to the discretion of the assessors; they have no mathematical rule which they can follow. In the British property and income tax, *Schedule A* is the most sure and certain group, on account of the prevalence of a universal system of leasing, and in the German states the values in the *cadastre* can be fixed with a high degree of certainty and accuracy on the basis of annual rental value or known annual produce. Nothing of that sort is possible in the United States. What is usually meant by the terms "full cash value," or "true value," is perhaps best defined as in the terms of the California statutes "the amount at which property would be taken in payment of a just debt from a solvent debtor." It is not what would be paid by the highest bidder, nor what the property might bring at a forced sale, but more nearly what it would be appraised at in the settlement of an estate for division among the heirs. This conception is at best vague, and leaves much to the discretion of the officers. Hence it is, that in order not to err by excessive valuations, the assessors, in practice, universally fall below the true value as defined by law. In states where a heavy state tax is apportioned on the basis of local assessments, there is a further motive for undervaluation; namely, the endeavour on the part of the assessor to save money for his constituents by evading part of the state tax. The prevailing practice of undervaluation has been recognised

by law in some states. Thus in Illinois only one-fifth of the true value is to be entered in the roll. But, nevertheless, undervaluation goes on just the same and the 20 per cent is computed on less than 100 per cent of the true value.

Far worse than the general undervaluations which create inequalities between districts are special or individual undervaluations. These are in *Inequalities* rare instances the result of corruption or *in valuation*. conscious favouritism; more often they arise from the natural inertia of the officials who do not make the roll keep pace with the changes in property and its value. Various devices have been resorted to, to obviate or lessen these inequalities. The official boards of review usually become mere umpires to decide disputes between assessors and dissatisfied taxpayers. Somewhat more successful in cities has been the introduction of a graduated scale of values in each block, the inner lots being valued according to their distance from the corner. In the West it is quite common to find a provision to the effect that unimproved land must not be valued at less than improved land of the same quality and similarly situated. This is doubtless a provision suggested by Henry George's theory.

A rather important provision, as tending to stimulate the assessor to take greater pains in his work, is that which requires that land and the improvements thereon shall be valued and assessed separately. This seems to have originated in California. It has re-

cently been rediscovered by New York, and adopted there with great enthusiasm.

The assessment of personal property presents the greatest difficulties. The main difficulty is to find *Assessment of personalty.* it. Some kinds of tangible personal property, such as cattle and animals on farms, wagons, machinery, tools, etc., are not difficult to find, and as easily valued. In states where there are large herds of cattle, as in Nevada, it is the custom for assessors to agree upon a uniform value per head. Household furniture can as easily be found, but difficulty at once arises over values. In every state, except New York, the taxpayer is by law required to fill out a minute inventory of all his furniture, and other personal property. But he frequently ignores the law, and the assessor proceeds by a sort of doomsday process, which amounts usually to a guess based on the general character of the house the taxpayer lives in, his household equipment, and his general financial standing. In New York, where no statement is required, the taxpayer is allowed to appear on "grievance day" and "swear off his taxes," if he feels that the guess made by the assessors is too high. The enforcement of the statement and the reliance placed upon it varies from state to state, and even from locality to locality within each state, to such an extent that no generalisation can be made with safety. It is certainly the intention of the law that every taxpayer should file a statement of his entire property, and the penalties for failure to do so are severe. But it is

equally true that this provision is not uniformly enforced, and that the vast majority of the statements filed are incorrect and incomplete. These statements usually have to be sworn to when filed, and the widespread perjury and consequent contempt of law constitute a sad and a menacing feature of the political life of the country.

SEC. 6. One of the moot questions in the United States is whether credits and money should be considered property for purposes of taxation. *The taxation of mortgages.* The debate on this question has been especially lengthy in connection with mortgages, because they are usually of record, or will be reported by the borrower, so that they are more easily discovered than other credits. If we include the evanescent forms of discussion, it is safe to say that there has been far more literature on the taxation of mortgages than on all other subjects relating to taxation in the United States.

In most states a note secured by a mortgage is taxable as property of the mortgagee, and the property which secures the mortgage is taxable to the mortgagor without deduction for the mortgage. It is obvious that this procedure rests on the old conception of the general property tax as a personal tax. The thought of the legislator is that the lender is able to pay a tax by virtue of the interest income he receives. That in most cases the lender will reimburse himself by shifting the tax to the borrower in the form of higher interest does not, in the opinion of the legis-

lator, present any good reason why an attempt, at least, should not be made to reach the lender. The most recent departure from this rule is to impose a special tax on the mortgage of the nature of a registration tax at a rate considerably lower than would be the result of taxing it as property. The property by which the mortgage is secured is then taxed in full to the borrower. This is in substance the outcome of the long struggle in New York State. This method assumes that the holding of the mortgage represents taxpaying ability of some sort vested in the lender. It is not unlike the conception underlying the Prussian law which imposes an additional tax on funded income in the form of a property tax, even though the income from the property has already been taxed as part of the taxpayer's income. Another solution of the problem is to treat the mortgage as an interest in the property and to try to divide the burden between the two parties. This in any case avoids double taxation. In California the attempt was made to compel the lender to pay the tax by at least making him advance it. It became evident, however, that he shifted the tax to the borrower, whose last state was worse than his first, because he had to pay not only the tax but the cost of shifting as well. In Massachusetts a similar compromise was made in that the mortgage and the surplus of the property over the mortgage were assessed separately, one to the lender and one to the borrower, but these two parties were allowed to agree

who should pay the mortgage tax. Generally the borrower assumed the whole burden with corresponding reduction in interest. This is obviously a round-about way of accomplishing a very simple thing, hence some few states simply ignore the mortgage entirely. Thus the statutes of Washington provide "that mortgages and all credits for the purchase of real estate shall not be considered as property for the purpose of taxation." Recently that state has extended the same principle to all credits. This latter provision simply legalises a prevailing practice, for credits other than mortgages were rarely found by the assessor.

It is the law in most of the states (Washington by recent enactment is one of the exceptions), and it is prevailing public sentiment, that money on hand, or on deposit, and credits are taxable property. But it is only in rare instances that they are taxed. Of the more usual attempts to uncover personal property of this class through the machinery of oaths, affidavits, and the like, Professor Daniels, in his work on Public Finance, says: "The effectiveness of such laws is inconsiderable. If Jove laughs at lovers' vows, he probably guffaws at taxpayers' oaths. Even the Psalmist's hasty allegation of universal mendacity needs little qualification in this province of finance. Where the taxpayer's conscience is tender, he finds (as one puts it) that virtue is perforce its own reward. This phase of the system is described in one

*Taxation of
money and
credits.*

tax report as 'a tax upon ignorance and honesty,' and in another report we are told that 'the payment of the tax on personalty is almost as voluntary and is considered in pretty much the same light as donations to the neighbourhood church or Sunday-school.'

There are two consequences of this almost universal evasion. The first is that when money is loaned under circumstances which make it at all likely that it will be found by the assessor, the rate of interest is raised above what it would otherwise be by an amount sufficient to cover the tax, together with another extra charge for the cost of shifting and attendant risk. The second is that any "ignorant and honest taxpayers" who may report this class of property are unduly taxed. It seems, then, to be futile to try to tax this class of property, and the underlying reason for the failure to reach it, and for the objection which people in general have to paying it, *is probably to be found in the fundamental fact that it should not be taxed at all.* Although credits may be included within the term "property," from the point of view of law, they are not property in any true economic sense. Like money, credits are representative wealth.

The following citation from the report of the California Commission on the reform of the revenue system of that state explains this point: *Credits should not be taxed.* "If we take the view that the property tax should be a real tax, based upon things or property without respect to who may own them, then it is

illogical to regard a credit as property. A credit is merely a right on the part of the creditor to receive and to enforce payment of the obligation due from some other person. The notes, bonds, or other documents embodying the credits merely stand as evidence of the existing contract. The very existence of the documentary proof and the phraseology in which many of these documents are couched demonstrate very clearly that the creditor himself is not in possession of the money, or lands, or the goods which secure the loan, and the transfer of which to the debtor brought the credit into existence. The creditor has only the right to receive these things, or similar things, back at some future time. If the United States government borrows \$100,000,000 upon bonds, — which are merely its promise to pay, — there is a transfer of \$100,000,000 in gold from the buyers of the bonds, or the creditors, to the United States treasury. The creditors who hold the bonds feel themselves no poorer than before, but no one would seriously contend that by this simple transaction the property or wealth of the country has been increased a particle. There is only \$100,000,000 of real wealth involved, which has passed into the possession of Uncle Sam from that of his creditors, and which will be returned when the bonds are paid. Nor would any one seriously contend that the payment by the United States of some of its indebtedness and the cancellation of the bonds destroyed any wealth. Standing against every credit there is an

equal amount of indebtedness, and the maturing of this indebtedness destroys no material wealth, nor does its creation add anything to the material wealth of the world or to the substantial property which has to bear the burden of taxation. To consider that credits are property as well as the goods and other property by which they are secured is like adding together two sides of an account — the assets and the liabilities. To treat credits as property, and also the lands, goods, and other forms of wealth in the hands of the community, would result in an obvious duplication of values, and if taxes were levied upon that basis would result in double taxation, unless the debtor were allowed to deduct the amount of his debts in the same way that we permit him to do in the case of mortgages. But the existing laws do not usually permit that, save and except that the debtor may deduct his debts from the amount of his credits. Illustrations of the way in which the taxation of credits works objectionable double taxation might be multiplied and the argument extended indefinitely, but the above illustrations ought to be sufficient to make clear the fundamental principles involved."

SEC. 7. As has been stated above, corporations, when subject to the general property tax, are generally regarded as legal persons and are taxed in the same manner as any other persons. A special difficulty is involved in the taxation of the so-called intangible personal property of the corporations. This class of property,

*Taxation of
corporation
franchises.*

sometimes called "the franchise," sometimes "the corporate excess," and often simply "the intangible property," is the capitalised value of that part of the net earnings that is in excess of a reasonable return on the amount invested in the real estate, machinery, and other tangible property of the corporations. Its value for purposes of taxation is usually obtained by ascertaining, first, the value of the real estate and other tangible property; second, the aggregate market value of the stock, bonds, and other funds representing the property; and third, by deducting the first from the second. The remainder is assumed to be the value of the intangible property. When the market value of the securities cannot be ascertained, the net earnings are capitalised in order to ascertain the aggregate value of the property. This whole process presents great difficulties and leaves much to the discretion of the assessing officials.

The legal theory is that this excess value is the value of a class of property called the franchises, conferred upon corporations by governmental authority. The courts have defined franchises as: "special privileges conferred by government on individuals and which do not belong to the citizens of the country generally by common right."¹ As these franchises are legally property, they are included in the taxable property. It is generally recognised that there are three, or possibly four, different kinds of franchises

¹ Such franchises are not to be confused with the right to exercise the electoral power.

that enter into and contribute to the corporate excess. But the attempt to assess or value them separately is rarely made, and in the nature of things is not successful. Their value merges in one mass with other elements analogous to "good-will," and the only practical method of valuation is to treat them as a unit.

The first of the franchises recognised by the courts is the right "to be" a corporation, a privilege
The right "to be." accorded to any three or more persons who associate together in the manner pre-

scribed by law for the formation of private corporations. This franchise conveys the right to use the corporate name, to have a corporate seal, to sue and be sued, and in general to enjoy the privileges ordinarily permitted to corporations. While this franchise is theoretically included with the others in the corporate excess, it is also subject to a fee at the time it is granted and may also, together with the second, be subject to an annual fee-like tax, in addition to the taxes imposed upon it as part of the property. These charges may be uniform or they may be graduated.

The second sort of taxable franchise is called the
The right "to do." franchise "to do and to act." This is inevitably conferred at the same time as

the first mentioned and is but slightly different in
Special and general franchises. character. Third, the revenue laws, as interpreted by the courts, seem to recog-

nise two other kinds of franchises, which we may call, for convenience, special and general, but they are so closely analogous as to be exceedingly

difficult to distinguish one from another. These are both subject to taxation as property, and are included in the assessment of the property of the corporations. One of these franchises requires a special grant; the other is acquired automatically under the enjoyment of the powers conferred by the general law for incorporation, and is, as will be explained below, very closely akin to "good-will." These two classes of franchises are here grouped together and treated as one class, simply because they are to be valued for purposes of taxation in practically the same manner.

The first of all to be recognised as taxable franchises were the special franchises enjoyed by public-service corporations, such as water companies, gas companies, street railway companies, and the like, which use the public streets, under some special permission. These are "special" in the sense that they have to be specifically described in each case and cannot be conveyed by general statute, and they virtually convey the right to use some public property. They are often very valuable, and that they were so was early recognised.

From the practice of assessing these special franchises there grew up the practice, which has frequently been sanctioned by the courts, of assuming that every class of corporations enjoys a sort of general franchise that is distinct from the mere right to be a corporation, or to act as a corporation. Thus banks have been taxed for their "franchises" and their value ascertained in the manner described

above. While these two classes of franchises, which for convenience we have called the special and the general, are apparently, in the opinion of the courts, almost precisely alike and are treated in the same manner for the purposes of taxation, they are, from the economic point of view, fundamentally different.

The franchise of a bank, in this sense, is closely analogous to that kind of property known as "good-will." This is a class of property which *Certain franchises analogous to "good will."* presumably might be taxed as property, but which as a rule is never taxed except in those cases in which it is enjoyed by corporations, and then it is taxed as a franchise. It is a question, open for serious consideration, whether the taxation of such a franchise, tantamount to the taxation of the good-will, against corporations, while similar items of property, if this be property, are not assessed against individuals and firms, does not constitute an unjust discrimination against corporations.

SEC. 8. The general property tax has been subjected to severe criticisms and has frequently been condemned. We may now examine the grounds on which this condemnation rests. Among many there are two of great importance. (1) It is urged that the tax is unjust because property forms no criterion of tax-paying ability. It is maintained *Objections to this tax.* that income is a far better basis. (2) It is urged that the general property tax is inexpedient because so difficult to administer justly, especially in the matter of the discovery and assessment of per-

sonal property and because of its effect on the movement of capital and forms of investment. Against these serious objections it is urged that when there is a tolerably just system of income taxation already in existence, a property tax in addition thereto fulfils the requirements of justice because it imposes a heavier burden on "funded" income, which is regarded as indicative of more faculty, since it is less precarious. It also supplements the income tax by making property in enjoyment, the use of which is an indication of tax faculty, a part of the base, as, for example, picture galleries. And, lastly, the comparative steadiness of the return from the property tax is a great recommendation from the fiscal standpoint. It would seem, then, that the objections to the general property tax as the main part of a system may still stand, but that there may *When this tax be room for such a tax as a subordinate is justifiable.* part of a larger system, the demands of justice being met by the proper relation between the different parts of the system. In Switzerland and Prussia the general property tax is part of a more elaborate system. In the United States it stands almost alone for commonwealth purposes, supplemented in some states by other taxes intended to reach certain forms of revenue-yielding property. The universal condemnation of the American commonwealth general property tax is therefore not due to the defects in the tax itself, but mainly to the fact that it is not properly supplemented by other taxes.

The first question that arises when the general property tax stands alone, and a question which, although not so prominent, also arises in other cases, is: Can the method of assessment be made sufficiently effective to reach uniformly and equitably all forms of property, especially personal property? The answer to this question that has been given by the experience of the United States is emphatically in the negative. This is especially true when the administration of the assessment is left to officials popularly elected for a short term, in small districts, and by the taxpayers whose property they are to assess. It is also in the negative, but somewhat less unanimously so, when the assessment is under the control of an impartial bureaucracy appointed by some higher authority and not beholden to a local constituency. In the one case the assessor is apt to be too friendly to the assessed, in the other too ignorant of local conditions.

Much light is thrown upon the question of assessment by the experience of the United States. In 1890, and again in 1900 and in 1904, the United States census office undertook to ascertain the true value of property, *i.e.* its fair selling value. This serves as a basis of comparison for the assessed values. The investigations of the census were conducted with the utmost care, and although they inevitably contain many unavoidable sources of error, they are yet very

Can the assessment be properly made?

Assessment in the United States fails.

serviceable. The following tables show the results of the investigations into the true value of property:

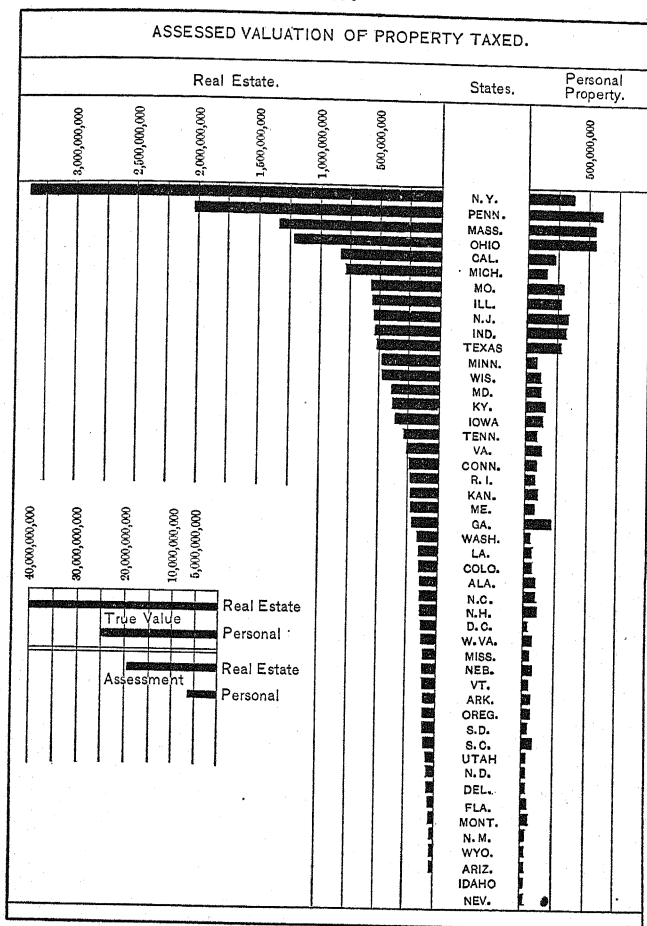
1890

Real estate, with improvements thereon . . .	\$39,544,544,333
Live stock on farms, farm implements, and machinery	2,703,015,040
Gold and silver coin and bullion	1,158,774,948
Mines and quarries, including product on hand . . .	1,291,291,579
Machinery of mills, and product on hand	3,058,593,441
Railroads and equipments, including street railroads	8,685,407,323
Telegraphs, telephones, shipping, canals, and equipment	701,755,712
Miscellaneous	7,893,708,821
Total	<u>\$65,037,091,197</u>

The total assessed valuation in 1890 was \$25,473,173,418, or about 40 per cent (41 per cent if we allow for \$3,833,335,225 exempt by law). Of real estate,—land and its improvements,—the true value was \$39,544,544,333, of which all but \$3,833,335,225 was legally subject to taxation; the assessed value of the \$35,711,209,108 taxed was \$18,956,556,675, a little over 50 per cent of its true value. The \$25,492,546,864 of personal property was assessed at \$6,516,616,743, about 25 per cent. But if we make allowance for the \$1,291,291,579 worth of mines and quarries which might be well classed as real estate, personal property was assessed at about $22\frac{5}{10}$ per cent of its true value. As the statement of the total amount of personal property erred admittedly on the side of moderation, there being some forms which were not ascertainable, this showing was more favourable to the assessment than the truth would have been. It is well within the truth to say that in the United States as a whole not more than 20 per cent of personal property was taxed in 1890. Probably considerably less than

this is the true figure. In many important commonwealths the assessment of personal property, even according to the favourable showing of the census, was far below the average for the whole country. In the country as a whole, personal property is about 71 per cent of real estate, or $41\frac{5}{6}$ per cent of all taxed property. In New York it was assessed at a trifle over 11 per cent of the real estate and about 10 per cent of all property. According to the census valuation, there was in New York in 1890 \$5,817,704,667 worth of real estate and \$2,758,997,324 worth of personal property. Real estate was assessed at \$3,403,751,246, or about 58 per cent of its real value, while personal property was assessed at \$382,159,067, or not quite 14 per cent of its real value. When it is remembered that the census report omitted some unascertainable items of personal property, it is fair to say that 90 per cent of the personal property in New York was untaxed, where at the same time only 42 per cent of real estate was untaxed. This means that the assessment of personal property was being evaded and that real estate was assessed below its actual value. The latter fault is not so bad as the former, because general under-assessment means merely a higher rate than would otherwise prevail, but does not, if uniform, affect the distribution of the burden. Pennsylvania, Massachusetts, and Ohio showed a somewhat better assessment of personal property. Thus in Pennsylvania the assessed value of personal property was 618 millions against 2042 millions of real estate; Massachusetts, 554 millions against 1600 millions; Ohio, 546 millions against 1232 millions. But no one supposes that there was any more personal property owned in these commonwealths than in New York. In fact, the contrary was the case. In some of the newer Western states the assessment of personal property was larger than the assessment of real estate. Thus in Montana personal property was valued at 58 millions, real estate 55 millions; in Wyoming the ratio was 20:13; New Mexico, 28:15; Arizona, 18:10; Nevada, 17:9; Idaho, 16:10. But this is easily explained.

1890



(1) In these states, land values had not yet developed. (2) The real property assessed was only such lands, with their improvements, as had fully passed into the hands of private owners. (3) Personal property was swelled by including in it the improvements upon public lands, the fee to which was still vested in the United States, and upon railroad lands the title to which was still vested in the railroad companies. (4) The list of personal property was swelled by the nature of some of the industries that prevail, — cattle. A certain amount of it was due to the assessment of railroad property as personal property. (5) The possibility of concealing property is less in a country where population is sparse and the conditions for investment well known to the assessors. (6) The need of revenues was very great, and real estate had not enough value to bear the burden. Personal property had, therefore, to be called in to raise the necessary amount without inordinately high rates. The chart on the preceding page taken from the Eleventh Census shows the relative assessment of personal and real property in all the states in 1890.

In matters of larger import the conditions revealed by the investigations of 1900 and of 1904 are not materially different from those in 1890. Hence the foregoing comments are practically true to-day. The new figures, for reasons that were unavoidable, are not strictly comparable with the old, but they are somewhat better in themselves and may be regarded as more reliable.

ESTIMATES OF WEALTH FOR 1904 AND 1900

FORM OF WEALTH	1904	1900
Total.	\$107,104,192,410	\$88,517,306,775
Real property and improvements taxed	55,510,228,057	46,324,839,234
Real property and improvements exempt	6,831,244,570	6,212,788,930
Live stock	4,073,791,736	3,306,473,278
Farm implements and machinery .	844,989,863	749,775,970
Manufacturing machinery, tools, and implements	3,297,754,180	2,541,046,639
Gold and silver coin and bullion .	1,998,603,303	1,677,379,825
Railroads and their equipment . .	11,244,752,000	9,035,732,000
Street railways, etc.:		
Street railways	2,219,966,000	1,576,197,160
Telegraph systems	227,400,000	211,650,000
Telephone systems	585,840,000	400,324,000
Pullman and private cars . . .	123,000,000	98,836,600
Shipping and canals	846,489,804	537,849,478
Privately owned waterworks .	275,000,000	267,752,468
Privately owned central elec- tric light and power stations	562,851,105	402,618,653
All other:		
Agricultural products	1,899,379,652	1,455,069,323
Manufactured products	7,409,291,668	6,087,151,108
Imported merchandise	495,543,685	424,970,592
Mining products	408,066,787	326,851,517
Clothing and personal adorn- ments	2,500,000,000	2,000,000,000
Furniture, carriages, and kin- dred property	5,750,000,000	4,880,000,000
Taxable	100,272,947,840	82,304,517,845
Exempt	6,831,244,570	6,212,788,930
Assessed valuation of taxable prop- erty	38,963,381,120	31,280,332,445
Percentage of assessed valuation to the true value of property taxable	36.4	35.3

In 1900 personal property, including railroads, street railroads, telegraph and telephone systems, and privately owned

waterworks, and electric light and power stations, which are better assessed than most other classes of property included, was assessed at 22 per cent, and in 1904 at 19.8 per cent of its true value, as against 44.4 and 48 per cent for real estate in the respective years.

The failure to assess personal property in the United States is due largely to the laxity of administration; the tax laws on the subject are usually strict enough to answer every requirement. What constitutes personal property is explicitly stated; the assessors have ample power to ascertain its exact amount. In all but one of the commonwealths the taxpayer is, or may be, required to make a declaration of his property. In all the states the assessors have the advantage of large powers of investigation, and can ascertain the amount of the property if they will assert their power. But this is what locally elected assessors are very reluctant to do. Much improvement has resulted in a few states from the introduction of strong central controlling boards. But this has not been in force long enough to enable us to determine how permanent this improvement is likely to be.

The advisability of extending the assessment to legal persons so as to cover a certain amount of property that might escape in the guise of personal property depends upon the strictness in the assessment. The stocks and bonds of railroad companies are easily concealable personal property of the individual stockholder. But the road and buildings are easily

The failure to reach personal property not due to faults in the laws.

The assessment of legal persons under the general property tax.

ascertainable real property of the companies. For ease of assessment, therefore, it is best to tax legal persons as well as real persons. But in that case stocks and bonds in the hands of private persons should be exempt, unless it is intended to tax such property more heavily than other property; *i.e.* to introduce a partial progression. Whether in addition to including legal persons in the general property tax a special corporation tax should be imposed is a question of policy affecting the whole tax system.

When the general property tax stands alone, all tax faculty that exists in the form of receipts of the economic character of wages—salaries, fees for professional services in independent professions, profits and earnings of management—are untaxed. In the earlier forms of the property tax in the United States this omission was seen, and a special tax levied upon such income. But at present that method of taxation has almost entirely disappeared.

SEC. 9. The property tax as the sole or chief form of direct taxation has few supporters among scientific writers. So universal and unanimous has been the condemnation heaped upon this tax that we must consider in detail some of the objections that have been raised.

Professor Seligman sums up his interesting discussion of this tax in words to the following general import :

The general property tax is a failure as the main

The taxation of faculty in the form of wages not accomplished.

Scientific judgment of the general property tax.

source of revenue from the triple standpoint of history, theory, and practice.

1. Historically, it was once well-nigh universal. In a community mainly agricultural it was not altogether unsuited to the conditions. But as soon as industry and commerce became important, it failed to extend so as to comply with the requirements of justice. It became, in fact, even where not so considered, a tax on real property. Everywhere but in America it has been (*a*) divided into a number of subordinate property taxes, (*b*) allowed to become a subordinate member of another system, or (*c*) entirely abandoned. Sooner or later it will have to be abandoned in America.

2. Theoretically the general property tax is deficient in two respects. First, it assumes that there is an ascertainable general property. But since property is a composite of inseparable but widely differentiated elements, this assumption is contrary to the fact. "The general mass of property has disappeared, and with it vanishes the foundation of the general property tax." Secondly, "property is no longer a criterion of faculty or of tax-paying ability." Two equal masses of property may be unequally productive, because used by men of differing talents, and thus differently joined with the personal element, or because the possession of them may give rise to fortuitous gains, or because the owner of one mass of property may be labouring under peculiar economic disadvantages.

It is the income which property yields that is the best index of the tax-paying power which the property represents.

3. Practically, "*the general property tax as actually administered to-day is beyond all peradventure the worst tax known in the civilised world.*" As at present administered, it fails entirely to reach intangible property. It debases public morals by putting a premium on dishonesty. It is regressive and presses hardest upon those relatively least able to pay.¹

This is strong language,—even stronger has been used.

PART 2. *Special Property Taxes*

✓ SEC. 10. The *land tax* is one of the oldest contributions. It has three forms: (1) it may be based upon each unit of area, sometimes with *Forms of the* an attempt to classify the different units *land tax.* as to fertility; (2) it may be based upon the estimated value of the land or upon an estimated average annual yield or surplus; (3) it may be based upon the actual yearly yield, and be as it were a share in the product. The tax was common in the latter part of the middle ages as a recognition of the monarch's right of proprietorship in the soil. A good example of this, among many others, is afforded by the so-called quit-rents in the American colonies.² In their first form these payments are not strictly

¹ Seligman, *Essays*, pp. 23-61

² See Ripley and Wood.

taxes. They are acknowledgments of the people's tenure. But they frequently grow into taxes. In France, as we have seen, the *taille* developed from feudal dues. The *impôt foncier* now yields 200,000,000 francs. In England the old land tax has been converted into a redeemable rent charge, but the revenue from land is still taxed in the general income tax and yields £1,500,000 annually. Local taxation in most countries falls largely on land. In Prussia the land tax was in 1895 transferred entirely to the local bodies.

Economic rent as the surplus of revenues from land, after all expenses have been deducted, has always been regarded as a legitimate object of taxation. It has been strongly argued that this tax cannot be shifted. But as the land tax is not always confined to rent-bearing land, being generally imposed upon all land, even the poorest in cultivation, and as modern economic theory does not regard rent as an inevitable surplus, this old argument needs thorough revision. (See Chap. X.)

It is in the assessment of this tax that the *cadastre* has been most widely used. The principles upon

Assessment. which the best *cadastres* have been built are the following: (1) A careful measurement of the land is made and recorded. In the older ones the land is entered in rough historical units: the "yoke," the "hide," the "seed." Sometimes the *cadastre* is intended to serve other purposes, as that of a record of titles. In any case the names

of the owners or occupiers are entered with each piece. (2) A record is made of the yield of each unit of area, and from that is estimated either the gross revenue or the net revenue, — more frequently the latter. As a rule the *cadastral* revenue is less than the actual net revenue. Another method is that of recording the market value.

The *cadaastre*, when finished, is subject to more or less frequent revision. A partial revision which involves the recording of changes of title, etc., is generally made currently. An entire revision is only undertaken after periods of considerable length. The making of a complete *cadaastre* is a matter of considerable expense and takes no little time. In many cases more than the mere land is recorded, buildings and other improvements being frequently entered in the same *cadaastre*.

It is generally urged in justification of the retention of the land tax, even in countries where there are other taxes that fall upon the revenue from land, that the income accruing from land is constantly increasing in every growing community, and that the expenditure of the government accrues largely to the benefit of the landholders, and appears in the form of an increased value or rental. The same reasons are urged in support of a higher rate for the land tax.

On the basis of a *cadaastre* the land tax is generally apportioned ; less frequently it is proportioned. In general, the tax lends itself better than most others

*Justification
of its retention
by the side of
other taxes.*

to the apportionment method. With a fixed valuation as a basis which varies comparatively little from year to year, it seems perfectly natural and easiest to apportion the amount that it is desired to raise, among the different pieces or units.

SEC. 11. The older forms of the land tax often included the *building tax*, with which it was closely connected in character. At present, this *The building tax originally part of the land tax.* contribution generally forms an independent tax on the revenue from the site and the building. It is, like the land tax, a tax on a fixed source of income. Its incidence will receive special attention elsewhere.

The buildings taxed may be classified according to value, or according to the uses to which they are put, *Forms of the building tax.* or according to their location, whether urban or rural. There are two very different forms of the building tax: one is intended to fall on the income derived by the owner from the building; the other simply taxes the occupier according to the rent, taken as the index of a certain amount of tax faculty on his part. The second is very much like a consumption tax. The first regards the revenue derived as a source from which the tax may be paid. But even this first form, when paid by an owner who is also an occupier, is very much like a consumption tax.

The building tax, wherever in use, is one of a number of other similar taxes; it never stands alone. In ease of assessment it has many advan-

tages. The valuation is simple and inexpensive. Alterations affecting the base can be easily and accurately ascertained. Unlike the land tax, the building tax is regularly assessed each *Assessment.* year. Hence this tax is more often proportioned than apportioned. The building tax may be extended into a sort of industry tax, as when it is assessed with higher rates upon buildings used for industrial or commercial purposes. An example of this method of assessing the business tax is that of France cited above.

SEC. 12. The taxes we have already considered cover most fixed capital. Circulating capital also, in all of its many forms, has been sub- *Taxation of* jected to separate taxes. This is as true *capital.* of those countries which have the general property tax as of those which attempt to accomplish the desired results by the taxation of the various elements of revenue. How to reach this kind of revenue and to make the faculty which it represents bear its share of the public burden is one of the most difficult practical problems of taxation. The chief difficulties arise from the elusive nature of circulating capital and the intimate way in which it is connected with many of the processes of industrial life. Justice and equality demand its taxation. But various pleas of expediency are against it. Capital is hard to reach, and if it is not fairly taxed, the result may be injurious to trade. There are two forms in which this tax has been applied

with some effectiveness. One is that of a tax on mortgages, the other that of a tax or taxes on corporations and banks. Some results have also been attained by the attempt to tax stocks and bonds. Public stocks are especially easy of assessment. But there is an objection to taxing them when the other forms of investment escape, because of the bad effect on public credit. If it is distinctly declared beforehand that the bonds are to be taxed, their selling price is lowered. If it is not so declared, at the time of issue, and the tax is subsequently assessed, the process is regarded by the holders as equivalent to a partial repudiation of the debt, and subsequent loans are looked upon askance. When, however, all forms of revenue-yielding capital are, nominally at least, subject to taxation, this objection to taxing public securities disappears. If the tax is not to have the effect of reducing the capital value of the stock, bond, or other security, it must fall upon every form of capital. But so great are the difficulties of making it thus universal that, as a general rule, such a tax affects the rate of interest on all new investments in the taxed form. This question will receive further attention under the head of Incidence.

Where there is a complete system of public records for deeds, mortgages, and contracts, necessary to their validity, it is comparatively easy to tax these recorded securities. Thus it is that mortgages are generally easily taxable.

This, however, results in inequality if the tax is not extended beyond the recorded contracts. When the mortgage is upon property already taxed, as, for example, by the building tax or a general property tax, the question arises whether both the borrower and the lender should be taxed, or only one, and if so, which one. An able writer says on this point, "Tax the mortgagee on the amount of the mortgage, and the mortgagor on the value of the property minus the mortgage. That is the only rational system."¹ Indeed, it would be, if every other form of capital were taxed; but when that is not the case, the result is in every respect the same as though the owner were taxed alone. Generally he pays more.

Taxation at the source has been warmly recommended for reaching interest on capital; *i.e.* to have the debtor advance the tax and shift it *Stoppage at the source.* if he can to the lender or share it with him. In the case of corporations, this method is applied to the dividends. As Bastable² has well shown such a tax is a combined tax on interest and on profits, and is therefore partly outside our present purpose. The taxation of corporations *Taxation of corporations.* is not always the taxation of circulating capital merely. Corporations often own other taxable property, — land, buildings, etc. But in the United States, one of the main objects of the intro-

¹ *Political Science Quarterly*, V., 35.

² P. 422,

duction of taxes on corporations was to reach forms of personal property that generally escaped. The other object was, of course, to extend the general property tax to cover all property. We find that the basis of the corporation tax is, in many instances, the capital stock at its par value, or at its market value; and in a good many instances, the bonded indebtedness is also included. When the nature of the business is such that the capital stock and bonds do not represent all the capital concentrated in the hands of the corporation, as, for example, in the case of banks and insurance companies, then the business transacted, the gross earnings, the dividends, or the net earnings become the basis. But no clear line is drawn between the taxation of interest and profits, so that corporation taxes often approach, in character and operation, business taxes.¹

SEC. 13. There remains but one other very important property tax, and that is the inheritance tax,

Origin of the inheritance tax. or the succession tax, sometimes called death duties.² The feudal "relief" and

"heriot" were payments made from the estate of a dead vassal, or by his heirs, in recognition of the lord's authority. Similar payments were made upon the transfer of property. But the

¹ The best discussion of this interesting field of taxation is contained in Chaps. VI., VII., and VIII., of Seligman's *Essays on Taxation*.

² See Max West, "The Inheritance Tax," *Columbia College Studies*, IV., 2; also the excellent chapters in *Bastable*, 2d ed., and Seligman, *Essays*, p. 307 ff.

direct connection between these feudal dues and the modern inheritance taxes is hard to trace. It is probable that the older dues suggested the feasibility of the modern inheritance tax. But no closer connection than that has been established. The modern inheritance tax is a special exercise of the taxing power. It is resorted to on account of the comparative ease with which large returns can be obtained at relatively little expense and without great friction. It is generally justified in one of two ways: (1) It is claimed that the deceased person has probably not paid his share of the general taxes during his lifetime, and that the publicity necessarily connected with the transfer of his property to his heir affords an excellent opportunity for the fiscus to "get even" with him. If this were the sole justification, it would require that the exact history of every estate should be investigated, and only those subjected to the tax that could be shown to have escaped taxation. But this would be a laborious and costly process. Another justification is, therefore, sought. (2) It is claimed that in all cases of collateral inheritance, the newly acquired wealth comes to the heir as a fortuitous, more or less unexpected gain. He had been living without it, and this sudden increment of wealth represents, temporarily at least, a sudden increase in his ability to pay taxes. This justification points to the necessity of exempting the inheritance by immediate dependents of the de-

*Justification
of the inheri-
tance tax.*

ceased. They were already living upon that property; and the death and breaking up of the family and of the estate represent to them not an increased, but a decreased, tax faculty.

An examination of the many forms of inheritance taxes reveals two main tendencies. The first is to exempt small estates and to establish a *Tendencies of modern inheritance taxes.* progressive rate for larger ones. The second is to exempt that portion of the estate passing to the immediate heirs. The grounds for this second exemption have already been examined. The grounds for the first are wrapped up in the general principles of a proportional or progressive rate. A very good example of these principles is afforded by the new English death duties of 1894, and the older "Legacy and Succession Duties" of 1881, which, however, are not progressive as to amount of property. Under the new law, the estate of every person dying after the 1st of August, 1894, must pay a duty which varies according to the following schedule as amended in 1907:

Estates from	£100 to	£500 pay	£1	0s. per hundred.
Estates from	500 to	1,000 pay	2	0 per hundred.
Estates from	1,000 to	10,000 pay	3	0 per hundred.
Estates from	10,000 to	25,000 pay	4	0 per hundred.
Estates from	25,000 to	50,000 pay	4	10 per hundred.
Estates from	50,000 to	75,000 pay	5	0 per hundred.
Estates from	75,000 to	100,000 pay	5	10 per hundred.
Estates from	100,000 to	150,000 pay	6	0 per hundred.
Estates from	150,000 to	250,000 pay	7	0 per hundred.
Estates from	250,000 to	500,000 pay	8	0 per hundred.
Estates from	500,000 to	750,000 pay	9	0 per hundred.

Estates from £750,000 to £1,000,000 pay £10	0s. per hundred.
Estates from £1,000,000 to £1,500,000 pay £10	0 per hundred
on £1,000,000, and £11 on the remainder.	
Estates from £1,500,000 to £2,000,000 pay £10	0 per hundred
on £1,000,000 and £12 on the remainder.	
Estates from £2,000,000 to £2,500,000 pay £10	0 per hundred
on £1,000,000 and £13 on the remainder.	
Estates from £2,500,000 to £3,000,000 pay £10	0 per hundred
on £1,000,000 and £14 on the remainder.	
Estates from £3,000,000 and over pay £10	0 per hundred
on £1,000,000 and £15 on the remainder.	

The older legacy and succession duties are also progressive, but in a different way, rising as the degree of relationship of the recipient of the legacy becomes more and more remote from the deceased, from £1 10s. in a hundred to £11 10s. in a hundred. Thus the total burden that may fall upon the share of any one person, that is, of a stranger to the blood receiving £3,000,000 or over, is 24.8 per cent.

In the United States the inheritance tax is growing rapidly in importance. This growth dates from 1885, but assumed greater dimensions after *Growth of the inheritance tax in the* 1900. As early as 1826 Pennsylvania *United States* adopted an inheritance tax, and a few other states followed her example. The federal government enacted such a tax in 1862 to meet the exigencies of war. But this tax was discontinued after the war, when the need for extra revenues ceased. But prior to 1885 the tax was of no importance, either from point of view of yield or influence. In the first edition of this book it was stated that at that time (1896) thirteen states were using the inheritance

tax. At the present time (1909) only sixteen of the fifty-one states and territories do not impose this tax.

While the use of this tax has been spreading from state to state, those having first adopted it have been busy intensifying it. At first it applied only to collateral heirs; since then it has been applied also to direct heirs. The rates, at first low, have been raised. The feature of progression, at first introduced with a trembling hand, has been more freely and boldly used. These taxes are now levied on all property passing by will, or by the intestate laws, or by transfer in *Property sub-* tended to take effect after death. But *ject to this tax.* in most states property passing to institutions of learning, to churches, or in short into hands where it would be exempt from the general property tax, is exempt from the inheritance tax. The widow and children usually enjoy large exemptions. The rates are usually graduated and are progressive in one or in two ways. They are almost always progressive as the relationship of the beneficiary to the deceased becomes remote. They are frequently progressive as the bequest (or as the estate) increases in amount. Although the states have copied freely from one another, there is as yet little uniformity, and it is not possible, so frequent are the changes, to distinguish a type. The most elaborate laws are those of Wisconsin and California, and these may possibly prove to be the type toward which the states are working. That of California will serve as an illustration. The

following table shows the principal features of that law :

CLASSIFICATION OR INDICATION OF RELATIONSHIP	PROPERTY EXEMPTION	APPLICATION OF RATES TO VALUE OF INHERITANCE OR BEQUESTS				
		On Excess after De- duction of Exemption from \$25,000	\$25,000 to \$50,000	\$50,000 to \$100,000	\$100,000 to \$500,000	In Ex- cess of \$500,000
Husband, wife, lineal issue, lineal ances- tor, adopted or mutually acknowl- edged child. . .	Widow or minor child, \$10,000. Others, \$4,000	1 %	1½ %	2 %	2½ %	3 %
Brother, sister, or descendant of either, wife or widow of a son, husband of a daughter . . .	\$2,000	1½ %	2½ %	3 %	3½ %	4½ %
Uncle, aunt, or de- scendant of either	1,500	3 %	4½ %	6 %	7½ %	9 %
Grand uncle, grand aunt, or descend- ant of either . .	1,000	4 %	6 %	8 %	10 %	12 %
Other degree of collateral consan- guinity, stranger in blood, body pol- itic, or corporate	500	5 %	7½ %	10 %	12½ %	15 %

A few examples will show how this law is expected to work. Thus, for example, a widow inheriting \$25,000 from her husband would pay 1 per cent on \$15,000, or \$150. If she inherited only \$10,000, she would be entirely exempt. If she inherited \$500,000, she would pay 3 per cent on \$490,000, or \$14,700. A stranger in the blood inheriting \$25,000 would pay 5 per cent on \$24,500, or \$1225; and inheriting \$500,000 would pay nearly \$75,000. This tax is paid by the executor or administrator direct to the county treasurer under the jurisdiction of the superior court of the

county in which probate proceedings are being taken. The county treasurers are allowed rather liberal fees for the collection of this tax in addition to their salary, or other compensation allowed by law.

The most radical inheritance tax ever enacted by any of the states is the one in the new State of Oklahoma. The rates are progressive in both ways, and for strangers to the blood confiscate all but \$100 of the entire bequest if it reaches \$94,500.

An examination of the statutes and of the discussions of this tax shows that the arguments in justification of it which have appealed most strongly to the American lawmakers are two in number: (1) "That the state has a right to curtail the right of bequest"; (2) "That it is desirable to curb the perpetuation of large fortunes." It was a sort of grim humour which led the Louisiana lawmakers to enact that if the heir could prove that the property he received had paid its full quota of taxes during the last five years of the life of the deceased, there would be no inheritance tax levied on it. But doubtless the "getting even after death" argument has had its influence elsewhere. The fact that here was a source of revenue, easily collected, which could be availed of to meet the growing expenses of the state governments without increasing the apparent tax burden, as revealed in the state tax rate on property, has, however, been the most potent of all the forces leading to the extension of this tax. It affords a revenue which, like that from indirect taxes, flows into the

treasury unseen by the legislator's tax-paying constituents other than the heirs affected.

The yield of this tax is coming to be large. In 1894 two states collected \$663,000 from this source; in 1892 six states collected \$3,107,000; *The yield of this tax.* in 1902, twenty-eight states obtained \$7,138,000; and in 1905, thirty states raised over \$10,600,000 by this means. The yield is, of course, irregular, varying from year to year by large amounts, so that it is not a suitable source of revenue for meeting regularly recurrent demands.

Most governments regard the inheritance tax as current revenue and do not attempt to treat its yield as a permanent endowment fund for any specific purpose. *The purposes to which the inheritance tax should be applied.* Inasmuch as the tax is so clearly drawn from the accumulated capital and not from the current income of the people, this appears to be an improvident use of the proceeds. While it might not be a wise policy to attempt to invest the entire proceeds and to spend only the interest thereon, yet it would seem wise to use this income solely for buildings or improvements of an enduring character. As, however, most governments do put into permanent improvements sums equal to or in excess of the yield of the inheritance tax, the failure to set it aside specifically for such purposes is not, perhaps, of immediate importance.¹

¹ It seems strange that the state universities in the United States have not demanded that the proceeds of the inheritance tax should be turned into their endowment funds. Such a use would be eminently fitting and would lessen the opposition to the tax.

Of recent years there has been much discussion of the advisability of a federal inheritance tax in the United States. The "legacy tax" enacted in 1862 as a war measure was repealed when the need for heavy taxation ceased after the close of the war. Such a tax is now urged as a means of reducing swollen fortunes, or as a substitute for the tariff. But behind the arguments advanced lies the desire to curtail the powers and importance of the states, and to correspondingly enhance the power of the federal government. It is a movement supported only by extreme federalists. The whole discussion seems to present a modern phase of the old "States' rights" problem. It is easy to show that the states can attend, just as effectively as can the federal government, to the punishment of men who acquire "tainted fortunes," if such a use of the inheritance tax is not a misuse, which it is in the opinion of many economists.¹ It is also easy to show that the federal government should continue to depend on indirect taxes, or that it is unwise to interfere with the states in working out a great experiment, but to do so would be beside the point. Until the states are forced to abandon all control over family relations, and to surrender to the federal government the entire field of legislation relating to property, and the inheritance thereof, it will be illogical and harmful for the federal govern-

¹ See the address by Bullock, before the National Tax Conference at Columbus, Ohio, 1907.

ment to tax inheritance. But that will not tie the hands of those who wish to force an issue as to the relative rights of the states and of the federal government in this field. The question is one of deep political import.

CHAPTER IX

PERSONAL TAXES

SECTION 1. The simplest form of personal taxation is the collection of an equal contribution from each citizen. But such a tax cannot be large, because if it were it would impose a burden beyond the ability of the poor. A poll tax by itself cannot yield sufficient revenue to support the government. The uniform *per capita* tax is not just unless all wealth is equally distributed, and only in a very primitive community is such equality found. Hence it is that, outside of the United States, the poll tax now possesses little more than an historic interest. In the United States the poll tax is used either for local purposes (usually for roads, or for schools) or for state purposes, or both for local and state purposes, in every state and territory except the District of Columbia and Maryland. In Illinois it is not used in all parts of the state. It is usually levied on all males between the ages of 20 or 21 years and 45 or 60. In Wyoming women are also subject to this tax. It is very laxly and poorly collected in almost all cases, being in general successfully evaded by many of those who have no other tax to pay. In four cases it takes the form of a fee for the registration of voters. In the early taxes of the commonwealths of the United States there was fre-

quently an assessment of each person at so much per poll as a part of the general property tax. In some commonwealths the poll tax still exists in this form. Originally this contribution was very generally used for road purposes. In many commonwealths there is still a road tax of so much *per capita* assessed upon those individuals who are found by the authorities in the road districts. The road tax is generally payable either in labour or in money.¹

The returns from the poll tax are generally insignificant. Despite the apparent ease of assessment, the poll tax is expensive to collect. It frequently causes much opposition and friction. It militates against the demands of equality, and has been superseded by other forms of personal taxation, which recognise differences in faculty.

SEC. 2. We have already seen how the poll tax in one instance developed into the income tax. That tax will now be studied more closely. *The theory of the income tax.* While it is true that, since the abolition of the federal tax, the income tax has little more than a theoretical interest for American readers,² yet inasmuch as the hopes of many reformers

¹ No comprehensive study of the American poll tax has ever been made, and no satisfactory account of it can be found in print. Its historical interest is so great that it would repay a careful investigation.

² Sixteen states have at various times used an income tax, and a few still use it. But the revenues obtained are insignificant, and the tax is of little importance in the United States. See Kinsman, *The Income Tax in the Commonwealths of the United States*.

centre in it, and inasmuch as it may any day, again, become a live question, it is well to give the theory of the tax some consideration here. While the general, or special, property taxes rest either on the benefit theory or on the faculty theory of taxation, income taxes are better defended from the standpoint of the faculty theory. It is easier to make it clear that income measures faculty than it is to show how income can measure benefit. To be sure, it has been claimed with some plausibility that income is a sure indication of the benefit enjoyed under the government. But that proposition requires more argument and explanation than does the simple statement that a citizen is able to pay more or less because he has a greater or a smaller income.

Besides this advantage of easier justification, the income tax has in common with all personal taxes another recommendation. It levies directly on the taxpayer. The nation's income from taxation is derivative. As such it is abstracted from the annual increment of wealth of the citizens. Any tax which is actually paid out of capital or property may be ruinous. Property taxes, as we have seen, are, theoretically, paid from the revenue earned by the property or out of other income of the owner, the property being at best but the indication of faculty or of benefit. But the income tax finds the indication of faculty in the source of the tax. There is a certain directness about this identification of base

and source which theoretically, at least, is a strong recommendation for this form of tax.

From the standpoint of the faculty theory no general property tax, and no system of special property taxes which has not, incorporated in it, a tax on wages, salaries, profits, and the like, can be called equal. Many persons enjoying comparatively little property live in luxury and ease from their personal gains, while many others possessing comparatively large property may be from time to time in serious straits. For example, to be "land poor" is to be poor indeed. Large property does not always imply ability to pay taxes, and the absence of property does not always imply absence of ability.

There has been a feeling in the United States, not always clearly expressed, yet strong enough to influence legislation, that the earnings of personal exertion, professional fees, and the like are not good subjects for taxation. This is the result of an extreme *laissez-faire* view, which decries every sort of interference with individual freedom. Every tax is seen or felt to have a repressive tendency, which is sometimes supposed to be one of the main objects in assessing taxes.¹ It is feared, then, that to tax the earnings of men would discourage exertion, would discourage industry. That this is a mistaken view

¹ A liquor license in a certain Western town cost \$100. A tax of \$100 was put upon banks. The bankers held up their hands in horror: "The people think the banks are as undesirable as the saloons!"

of the nature of taxation, will, in the light of our whole discussion, be evident from the mere statement. A general tax on all income would not discourage income getting, but might even act as a stimulus thereto, more income being required to meet the tax and the same expenses as before. It may be true that this form of income represents less faculty than income from property, because more precarious than the latter, which furthermore leaves the owner free to engage in the getting of other income. But the entire exemption of personal earnings cannot be justified.

SEC. 3. The form of the income tax will be determined by the place given it in the system of taxation. If it were possible to administer a single tax of any sort in accord with the demands of justice, the income tax would be, theoretically, the one to be chosen. But the objections to any single tax, already stated, bear upon this as well as upon any other. Theoretically, it is best to make the income tax the central one of the system, the gaps of which are filled in by other taxes. If this be the intention, then the income tax can be arranged in the form in which it is most easy to administer. Thus the very small incomes can be exempt from the income tax, being covered by direct and indirect consumption taxes. In this way one source of difficulty and friction is avoided. Then no distinction need be made in the assessment of income from different sources. For if it be decided

*The place of
the tax in the
system.*

to tax income from funded investments at a higher rate than other forms of income, this additional tax can be laid on in the form of a property tax. How far the exemption of smaller incomes should go, or to what extent funded incomes should be more heavily burdened, depends upon the concrete facts in each case. An abatement of the burden in cases where there are already more than the usual claims on the income, as of a large family, is also sometimes given.

SEC. 4. As an example of such a tax, not, perhaps, ideally perfect, but still laid down in accord with the general principles enunciated *Prussian income tax.* above, we will study somewhat in detail

the Prussian income tax.¹ In order to have in mind the main features of the development already outlined above, Chap. V., we quote from Mr. Hill the successive stages in the growth of personal taxation in Prussia:

"1. A uniform poll tax, 1811.

"2. A class tax, collecting somewhat more from the prosperous, and not less from the poor, 1820-1821.

"3. To supplement the class tax, an income tax with comparatively few classes, a uniform rate, and a maximum limit, 1851.

¹ For history see Hill, *Quarterly Journal of Economics*, VI., 207; Wagner, "Die Reform der directen Staatsbesteuerung in Preussen im Jahre 1891," *Schanz' Finanz Archiv.*, VIII Jahrgang, II. Band. A full statement of the law is there appended.

"4. Classification made finer, the maximum limit removed, and the class tax below made practically an income tax with a progressive rate, and the exemption of incomes up to 420 M., 1873.

"5. Exemption of incomes up to 900 M., reduction of the remaining rates of the class tax, and of the two lowest rates of the income tax, 1881-1883.

"6. Principle of progression extended to all incomes under 100,000 M., incomes under 10,000 M. taxed less than before, and higher incomes more; a declaration of income by the taxpayer required, and a finer classification adopted, 1891."

To make the new tax still more clear, we quote the rates from the law itself:

TARIFF OF RATES

INCOMES		RATE	INCOMES		RATE
From M.	To (inclusive) M.	M.	From M.	To (inclusive) M.	M.
900	1,050	6	3,900	4,200	92
1,050	1,200	9	4,200	4,500	104
1,200	1,350	12	4,500	5,000	118
1,350	1,500	16	5,000	5,500	132
1,500	1,650	21	5,500	6,000	146
1,650	1,800	26	6,000	6,500	160
1,800	2,100	31	6,500	7,000	176
2,100	2,400	36	7,000	7,500	192
2,400	2,700	44	7,500	8,000	212
2,700	3,000	52	8,000	8,500	232
3,000	3,300	60	8,500	9,000	252
3,300	3,600	70	9,000	9,500	276
3,600	3,900	80	9,500	10,500	300

The rate increases

FROM M.	TO M.	IN STAGES OF M.	BY M.
10,500	30,500	1,000	30
30,500	32,000	1,500	60
32,000	78,000	2,000	80
78,000	100,000	2,000	100

In the case of incomes from 100,000 M. to 105,000 M. the tax is 4000 M. And from that point on the proportional rate of 4 per cent is assessed upon the lower limits of stages of 5000 M. each.

This rate is progressive from about two-thirds of 1 per cent at 900 M. to 3 per cent at 10,000 M. Then the rate is nearly proportional at 3 per cent up to 30,000 M. Then progressive again, until at 100,000 M. 4 per cent is reached, after which it is proportional again. Each taxpayer having an income of over 3000 M. is required to "declare" it. He has to fill out a blank calling for a statement of income from each of four sources: (1) from capital invested, interest and dividends; (2) from landed property and houses, including all crops, whether consumed in the house or not, but deducting the cost of cultivation; (3) from trade, industry, or mining, deducting the cost of maintenance; (4) from any employment, wages, salaries, fees, and including pensions and every source of income not covered by

*The form of
the declaration.*

(1) (2) and (3).. Deductions are allowed (1) for interest on debts, except that on business debts; (2) for permanent legal burdens (example, maintenance of reserves); (3) contributions to sick funds; (4) life-insurance premiums. This division of the income into different parts is for the sake of accuracy of declaration, not for the sake of assessing different rates on the different kinds of income.

Persons with large dependent families or labouring under any special economic conditions seriously affecting their faculty are allowed an *Abatements allowed.* abatement of not more than three grades, provided their incomes are not over 9500 M. Persons having less than 3000 M. deduct 50 M. for each child under fourteen years of age, and if there are three such children, a reduction of one grade is made.

Corporations and stock companies pay the income tax on all dividends over $3\frac{1}{2}$ per cent. This makes double taxation of this income, which is regarded as particularly "capable." In other ways the attempt is made to tax funded income more heavily. The exemption of incomes below 900 M. (\$225) and the lower rate for smaller incomes is justified on the ground that the consumption taxes already impose a burden on these persons.

The assessment of the tax is not perfect. It is said to be considerably better, however, than the assessment of property in America. Large incomes escape in part. It has, however, an advantage in

that the evasion of the tax does not in Prussia as it does in America intensify existing differences and inequalities. Other parts of the system tend to offset the failure in this case.

SEC. 5. The British income tax, correctly called "the property and income tax," may serve as another illustration, but it differs very much from the Prussian. Logically, this tax might have been treated in the

*The property
and income
tax in Eng-
land.*

previous chapter, but it is as well to discuss it here. In the first place, as has already been stated, it is rather a system of taxes on revenue than a tax on the aggregate income of each person. It is a system of modified property taxes, with a wage and salary tax appended. In Prussia the intention is to make the total income the base irrespective of the source, and reference to the sources is called for in the declaration merely as a means of getting at the total with greater accuracy. In England the different sources are kept strictly apart, and there is a difference made in the treatment of each kind of income, the tax being in some cases "stopped at the source." The total income is with some exceptions called into use only in estimating the exemptions and abatements. The taxpayer has the right by summing up his whole income to show that he has been taxed too much, or is entitled to exemption. In that case he is reimbursed. In 1907-1908 the abatements proper amounted to £885,670; exemptions on account of small incomes amounted

to £886,134. The total abatements of all sorts, £2,798,289. So separate are the different parts of this tax that Mr. Wilson says of it :¹ "To the bulk of the people it is known in its most obnoxious (?) form as a tax upon ordinary incomes, salaries, professional earning, profits of trading, etc." Bastable (p. 449) says: "Inequalities are, however, removed by the comprehensiveness of the tax."

The various revenues are taxed in five "schedules," known as *Schedules A* to *E*.

The following outline of these schedules from the Acts of 1842 and 1853, with subsequent amendments, is taken mainly from Williams' *The King's Revenue*, a most admirable compilation, which should be frequently consulted by every student of British finance.

"*Schedule A*.—For and in respect of the property in all lands, tenements, hereditaments, and heritages in the United Kingdom, and to be charged for every twenty shillings² of the annual value thereof :

"*Schedule B*.—For and in respect of the occupation of all such lands, tenements, hereditaments, and heritages, as aforesaid, and to be charged for every twenty shillings² of the annual value thereof :

"*Schedule C*.—For and in respect of all profits arising from interest, annuities, dividends, and shares of annuities payable to any person, body politic or corporate, company or society, whether corporate or

¹ P. 115, *National Budget*.

² See below for "deductions" allowed. Under *B* only one-third the annual value is now charged. The text gives the old law.

not corporate, out of any public revenue, and to be charged for every twenty shillings of the annual amount thereof :

“*Schedule D.*—For and in respect of the annual profits or gains arising or accruing to any person residing in the United Kingdom from any kind of property whatever, whether situate in the United Kingdom or elsewhere, and for and in respect of the annual profits or gains arising or accruing to any person residing in the United Kingdom from any profession, trade, employment, or vocation,¹ whether the same shall be respectively carried on in the United Kingdom or elsewhere, and to be charged for every twenty shillings of the annual amount of such profits and gains :

“And for and in respect of the annual profits or gains arising or accruing to any person whatever, and whether a subject of His Majesty or not, although not resident within the United Kingdom, from any property whatever in the United Kingdom, or any profession, trade, employment, or vocation, exercised within the United Kingdom, and to be charged for every twenty shillings of the annual amount of such profits and gains :

“And for and in respect of all interest of money, annuities, and other annual profits and gains not charged by virtue of any of the other schedules contained in this Act, and to be charged for every twenty shillings of the annual amount thereof :

¹ See lower rates for “earned” incomes, explained below.

“*Schedule E*. — For and in respect of every public office or employment of profit, and upon every annuity, pension, or stipend payable by His Majesty or out of the public revenue of the United Kingdom, except annuities charged to the duties under the said *Schedule C*, and to be charged for every twenty shillings of the annual amount thereof.”

All incomes not exceeding £160 are exempt. The following “abatements” are allowed on all classes of income: £160 on all incomes exceeding £160 and not exceeding £400; £150 on incomes exceeding £400 and not exceeding £500; £120 on all incomes exceeding £500 and not exceeding £600; £70 on all incomes exceeding £600 and not exceeding £700.

The following “deductions” (not called abatements) are allowed under *Schedule A*, namely, one-eighth in respect of lands, and one-sixth in respect of houses for repairs, etc. That is, income from lands is charged at 17s. 6d. for each pound, and that from buildings at 16s. 8d. per pound.

“Relief,” in the form of a reduced rate, is given by an act passed in 1907 to “earned” incomes, in addition to all other exemptions, abatements, or deductions. “Earned” income means —

(a) “any income arising in respect of any office or employment of profit held by the individual, or in respect of any pension, superannuation, or other allowance, deferred pay, or compensation for loss of office given in respect of the past services of the in-

dividual, or of the husband or parent of the individual, in any office or employment of profit . . . ; and

(b) "any income from any property which is attached to or forms part of the emoluments of any office or employment of profit held by the individual; and

(c) "any income which is charged under *Schedules B or D*, and is immediately derived by the individual from the carrying on or exercise by him of his profession, trade, or vocation, either as an individual, or, in the case of a partnership, as a partner acting therein."

This "relief" extends only to earned incomes up to £2000.

The reader should note the careful distinction made in the law between "persons" and "individuals." The former includes legal persons, such as joint stock companies and corporations other than governmental. This is especially important under *Schedule D*.

"The annual value of lands, etc., charged under *Schedule A*, is understood to be the rent by the year at which the same are let at rack-rent, if the amount of such rent shall have been fixed by agreement commencing within the period of seven years preceding the fifth day of April next before the time of making the assessment, but if the same are not so let at rack-rent, then at the rack-rent at which the same are worth to be let by the year." This rule does not

apply to tithes, quarries, mines, etc., but does apply to lands, etc., capable of actual occupation, no matter how enjoyed.

"Only one-third of the annual value is charged under *Schedule B*; nurseries and gardens are charged under *Schedule D*." Mortgages are taxed under *Schedule A*, owners being allowed to deduct what they advance in taxes from the interest they pay. Owners in occupation pay under *Schedule B*.

Clergymen or ministers of religion are allowed a deduction of one-eighth on the value of any dwelling-house for which they pay rent, in respect of the portion of it which they may use for official purposes.

The greatest difficulties of assessment arise under *Schedule D*, and in 1907 the assessors were empowered to require an employer to give particulars of name, residence, and pay of any employees, and every person is made liable to be called upon to make a full return of his or her income. Normally the income taxable is the average of the profits or gains for the past three years, but if the taxpayer so elect, he may be assessed on the actual amount of profits and gains for the year. Commissioners are empowered to make deductions in respect of "wear and tear" of machinery or plant used, and, generally speaking, the assessable profits are what are left after deduction of all outgoings attributable to the expenses of materials, labour, etc. Individuals are allowed to deduct life insurance premiums paid.

Many of the terms used in the schedules as quoted

above will probably be unintelligible to American readers, as some of the forms of income to which they apply are not found in the United States, or at least are not commonly recognised as distinct classes. On that account the following exhibit of the amount of income "brought under review" by the department administering this tax will probably prove instructive. The details of gross income are for the fiscal year 1905-1906, and the whole table is from Williams, *The King's Revenue*.

Schedule A. Profits from the ownership of:

Lands	£52,151,543
Houses	205,486,455
Other property	1,310,673
	<hr/>
	£258,948,671

<i>Schedule B.</i> Profits from the occupation of lands (farmers' profits mainly)	17,460,062
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<i>Schedule C.</i> Profits from British, Indian, colonial, and foreign <i>government</i> securities	46,925,674
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Schedule D. Profits from businesses, concerns, professions, employments (except the last of a public nature, see *Schedule E*) and certain interest:

I. Businesses, professions, etc. (including salaries of employees), other than those enumerated below	£367,814,155
II. Railways in the United Kingdom	41,241,692
III. Mines	19,999,972
IV. Gas works	7,413,611
	<hr/>
Carried forward	£323,334,407

	<i>Brought forward</i>	£323,334,407
V. Iron works	2,683,637	
VI. Waterworks	5,816,300	
VII. Canals, etc. . . .	3,847,201	
VIII. Quarries	1,695,799	
IX. Markets, tolls, etc. .	869,635	
X. Fishings in the United Kingdom and sporting rights in Ireland	203,304 ¹	
XI. Cemeteries	183,612	
XII. Salt springs or works and alum works .	150,573	
XIII. Indian, colonial, and foreign securities (other than government)	14,794,821	
XIV. Coupons	12,061,156	
XV. Railways out of the United Kingdom .	16,111,221	
XVI. Loans secured on the public rates	6,687,134	
XVII. Other interest . . .	4,677,654	
XVIII. Other profits . . .	2,399,047	
XIX. Profits from the occupation of lands, the occupiers of which have elected to be assessed under <i>Schedule D</i>	13,821	
		£508,664,345
<i>Schedule E. Salaries of government, corporation, and public company officials</i>		£ 93,185,804
Total gross income brought under review 1905-1906		925,184,556
Less deductions, abatements, etc.		293,159,810
Taxed income		£632,024,746

¹ Some sporting rights are under *Schedule A*.

The income taxes are, whenever possible, "stopped at the source," that is, they are paid to the government before the income (the rents, interest, salaries, etc.) is paid over to the recipient. This has long been considered the characteristic feature of the British income tax. Williams estimates that two-thirds of the taxes are thus indirectly collected. Stoppage at the source applies to practically all of *Schedule A* and to all of *Schedules C* and *E*. On account of the definiteness of incomes under *Schedule B* the collection is equally certain. Even under *Schedule D* many items can be stopped at the source.

The following hypothetical case of a composite income of £5000 per annum given by Williams will illustrate some of the more puzzling points:

REFERENCE NUMBER	SCHEDULE	ITEM	AMOUNT
1	A	Profits from the ownership of lands, houses, etc.	£500
2	B	Profits from the occupation of lands at one-third the annual value	200
3	C	Profits from government securities	200
4	D	Profits as an author	100
5	D	Profits as a solicitor (partner in a firm — total profits, £5000)	2500
6	D	Profits from investments in a public company (total profits, £55,000)	500
7	D	Profits from investments in munici- pal stock	100
8	D	Profits from investments in foreign bonds payable by coupons cashed in the United Kingdom	100
9	D	Salary as a land agent	500
10	E	Salary as a borough auditor	300
		Total	£5000

The method of taxing items 1, 2, and 3 are simple and require no explanation.

Item 4 is income as an individual and, although not over £160, is not exempt because this individual's total income is over £160. It is, however, "earned" income and would be entitled to "relief" but for the fact that the total of this individual's income is over £2000.

Item 5 requires no explanation.

Item 6 is income on which the tax would be paid by the company, as a "person" having income beyond the limits of any abatements, that is, £55,000, the highest sum entitled to abatement being £700. Even if the hypothetical individual in this case had less than £700, instead of £5000 income, he would receive no abatement on this item. Technically this tax is collected directly and not "stopped at the source," but so far as the individual is concerned, the effect is much the same. This is the only item "net," less the tax appearing in the list.

The taxes on all the remaining items, 7 to 10 inclusive, are "stopped at the source" that on 8 being withheld by the banker or broker when he cashes the coupons.

The income tax is the variable element in British finance, and the rate is fixed each year with reference to the needs of the government. From 1896 to 1900 the rate was 8*d.* in the pound; 1900-1901, 1*s.*; 1901-1902, 1*s.* 2*d.*; 1902-1903, 1*s.* 3*d.*; 1903-1904, 11*d.*; 1904-1908, 1*s.* But since 1906, "earned" incomes

paid only 9*d*. There are many other interesting points connected with the British income tax for which the reader is referred to the larger treatises.

SEC. 6. The United States federal government has made two attempts to establish an income tax. The first was a war measure, and was repealed as soon as the pressing necessity was removed. The second was, like the English income tax in 1842, a means to make up the estimated deficit resulting from the repeal of the protective duties. It failed to go into effect, however, as the Supreme Court could not be convinced of its constitutionality.

*Income taxes
in the United
States.*

We shall consider the Civil War tax first.¹ The Constitution provides:

"No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration hereinbefore directed to be taken." Article I., sec. 9.

Also, "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three-fifths of all other Persons." Article I., sec. 2.

And, ". . . all Duties, Imposts, and Excises shall be uniform throughout the United States." Article I., sec. 8.

¹ See *Quarterly Journal of Economics*, VIII., 4; also July, 1889.

Early in the search for revenues to support the war a proposition was made for the apportionment of a tax of \$30,000,000 in accordance with these provisions. But it was felt that population was no measure of the wealth of the different states, and that such an apportionment in 1861 would not result, as one in 1789 might have done, in imposing fairly equal burdens upon all the citizens. In lieu thereof, an income tax of 3 per cent on all incomes with an exemption of \$800 was voted. In the case of *Springer v. the United States*, 102 U. S. 586, the Supreme Court decided that such a tax could be levied, since it was not a direct tax within the meaning of the Constitution.

The tax was to go into force a year later. But in 1862 it was amended, making the deduction \$600 and the rate progressive. Incomes from \$600–\$10,000 (less \$600) paid 3 per cent, all over that 5 per cent. In that form it went into effect. The great war tax law of June 30, 1864, made the rates as follows: 5 per cent on the excess over \$600 up to \$5000; 7½ per cent on the excess over \$5000 up to \$10,000; and 10 per cent on the excess over \$10,000. But again, before the law went into effect, the 7½ per cent rate was cut out and 10 per cent was collected from all incomes over \$5000. On all incomes derivable from the public funds¹ the tax was stopped at the source. In 1867 the tax was reduced and the rate made 5 per cent with an exemption of \$1000, and it

¹ Except interest on bonds.

remained thus until 1870. The income tax was, in a way, conjoined with one on corporations, banks, insurance companies, railroads, etc. The part of the individual's income taxed in this latter way was deducted before the income was assessed. No attempt, however, was made to make the rate of this tax progressive. It was first 3 per cent and later 5 per cent, and there were no exemptions. The assessment was made on the basis of a written declaration by the taxpayer, subject to correction by such information as the assessor could gather. Generally the information upon which the tax was assessed was published in the newspapers. During the period when patriotic feeling ran high, incomes were well returned and the proceeds of the tax were large. After that, evasion by false declaration became prevalent and the returns fell off materially. With the general removal of war taxes in 1870 the income tax fell away. The protective policy, which demanded the retention of the customs duties, rendered it possible to do without the revenue from this source.

The reduction of the customs duties in 1894, and the probability of a falling off in the revenues from this source led to the second income tax.¹ *The income tax of 1894.* The law for this tax, faultily drawn and more or less incorrect in principle, was declared unconstitutional by the Supreme Court in 1895 before it went into effect. The grounds for this decision, which reversed that in the case of *Springer v. the*

¹ *Quarterly Journal of Economics*, IX., 1.

United States, by which the other tax law had been tested, were that the tax was a direct tax and also not uniform inasmuch as all incomes below \$4000 were exempt. As the decision now stands, no income tax can be levied by the federal government without a constitutional amendment.¹

This income tax was to be for five years, commencing 1895. It was degressive, at 2 per cent, on all incomes in excess of \$4000. It was levied upon "the gains, profits, and income" of all citizens and residents, "derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation," "or from any other source whatever." Debts, and interest thereon were exempt. The cost of stocking the farm and home consumption of products were not included. Accretions by gift or inheritance were to be counted as income. All persons having an income of over \$3500 were required to declare their incomes. The individual stockholder in a corporation was allowed to deduct the income from his shares in making his return. Public corporations were exempt, but other corporations were not. State and local taxes except special assessments might be deducted. United States officials were taxed on their salaries. Returns were to be confidential.

It will easily be seen that this was a combination of an income tax with an inheritance and

¹ In 1909 Congress submitted to the states for approval a constitutional amendment permitting the federal government to levy an income tax.

corporation tax. That it would necessarily have worked badly on that account is not clear. The rate was so low and the exemptions so liberal that pretty full returns might have been anticipated. The law, however, was loosely drawn, faulty in wording, and even contained clauses taken from the laws of the Civil War tax having no possible meaning or bearing in the connection in which they were used. No attempt was made to adjust the tax to the existing burden of state and local taxes.

The taxation of income by the commonwealths of the United States is rare and entirely without leading principles. In Virginia alone there is a general income tax. It is supposed to be a tax of 10 per cent on all incomes over \$1000. But the returns obtained in this commonwealth are insignificant because of the lax assessment. Partial income taxes, intended to supplement the personal property taxes and to cover the annual saving, exist in Massachusetts, Pennsylvania, Tennessee, and North Carolina.¹

¹ See Seligman, "Finance Statistics," *Publications of The American Statistical Association*, New Series, 8, December, 1889. Also the Special Report of the United States Census Bureau (1907) on Wealth-Debt and Taxation, and Kinsman, *The Income Tax in the Commonwealths of the United States*.

CHAPTER X

THE INCIDENCE OF TAXATION

SECTION 1. We postponed a treatment of the question of incidence in connection with each tax, because the incidence of any tax depends upon its place in the system. It seems, therefore, better to treat the subject by itself in such a way that every tax can be considered in its connection with other taxes. The problems of this part of the subject are many and difficult. In an elementary treatise, all that can be done is to suggest methods of study and a very few of the more simple principles.

By the term "shifting" is meant the transference of the burden of a tax from the payer to some other person or persons. By the "final incidence" is meant the falling of the burden, without possibility of further shifting, upon some particular revenue, property, expenditure, or person. This may be illustrated by two very simple cases. An American bookseller in a college town imported some books from England for the use of the students. He paid the duty to the custom house, but collected it again from the students in the shape of an addition to the price of the

Incidence depends upon the system.

The meaning of shifting and of incidence.

books. The bookseller shifted the tax. The final incidence was on the students. In this case, the shifting was expected by the lawmaker. It was to save the expense of hunting up and taxing each user of the books in question, that the seller was made to pay the tax, or to be the agent of the government in collecting it. Since the students thus taxed cannot shift the burden, we need not investigate this case further. Again: in California, the commonwealth and local taxes paid by the mortgagee amount on the average to about $1\frac{3}{4}$ per cent. The current rate of interest on the best untaxed loans, in and around San Francisco, is about 6 per cent, but on mortgages, in spite of the good security, it has been almost invariably 8 per cent, or more. In this case, the mortgagee shifts the tax, and its incidence is on the mortgagor. This may be its final incidence, or it may be conceivably possible for the mortgagor to shift the burden to the tenant of the mortgaged property in the shape of higher rents, or to the purchasers of the commodities raised on the property in higher prices. This last illustration shows how complicated the problem of incidence may be.

SEC. 2. Each and every tax must be studied in its proper connection if it is desired to know to what extent the aims of taxation are realised. Sometimes the shifting of the tax defeats the general purpose, as in the case of the tax on the mortgagee's interest in

*Shifting may
or may not de-
feat the pur-
pose of the tax.*

California, while in others the general purpose can only be accomplished when the tax is shifted. The process of shifting, like every other economic transfer of burdens, costs something. No person advances the amount of the tax with the intention of transferring it to some other without desiring to be paid for his trouble and risk. Unless the conditions are against him, he will succeed in getting paid for it. Thus, the importer of books tries to get a certain profit on the cost to him, which is composed of the price in England plus the cost of transportation and the duty. If the rate of profit or commission which he reckons is 10 per cent, he adds 10 per cent of the duty as well as of the other items. The money which he has advanced on the duty must bring him its share of the earnings. So in the case of the mortgages in California. One-quarter of one per cent interest, or more, is usually charged above the rate plus the tax. If the lender has to suffer the annoyance and run the risk of paying the tax, he will have to be reimbursed. Shifting is a costly process. Shifting is, therefore, an undesirable and costly process, and is to be avoided unless there is some clear saving, as in the case of the customs duties.

SEC. 3. The aims of taxation, the accomplishment of which shifting may aid or defeat, have been stated in the form of canons. The oldest and most famous are the four of Adam Smith.¹ The fourth of these

¹ *Wealth of Nations*, Bk. V., Chap. II., Part II.

famous canons bears directly upon the problem in hand. Shifting adds to the burden without adding to the revenue coming into the treasury. *Sometimes a shifted tax is more productive.* Sometimes, however, by assessing the tax upon a part of a great economic process and permitting of a certain shifting, the tax is made more productive to the treasury. Now it is clear that the first duty of the fiscal officer is to fill the treasury as quickly and easily as possible. He has, therefore, no right to pass over a tax that is productive, in favour of one that is not, simply because the one is shifted and the other is not. If, however, it can be seen that the incidence is such as to entirely derange the system adopted and defeat the general aims, an attempt must be made to prevent it. If a tax can be found that is productive and at the same time is not shifted, it will be preferred to one that is shifted.

It follows directly from the fact that a tax should be as "productive" as possible, that those taxes chosen should have as little repressive effect as possible.¹ For, to destroy the phenomenon is to lose the return.

SEC. 4. Let us suppose that the ideal by which all systems are to be tested is that the total taxation shall impose a slightly progressive burden upon all incomes. Then it is necessary to examine all the

¹ See Bastable, pp. 388, 389, for the same idea; also Ross, "A New Canon of Taxation," *Political Science Quarterly*, Vol. VII. This is no very new canon. Adam Smith said: "Taxation should retard as little as possible the growth of wealth."

taxes with their various shiftings and to see how the total shifting affects the final result.¹ It is a fundamental principle, too often overlooked in the discussion of incidence, and one that cannot be too frequently restated, that the possibility of shifting

Shifting cannot take place when the tax is universal.

depends largely upon the relation of the tax in question to the other parts of the system. Let us use an old illustration: the tax on mortgages is in California shifted to the mortgagor because there are other investments for capital that escape taxation. If every possible channel into which capital might go led to the payment of a similar tax, it would not be so possible as it now is to shift this tax. It is not quite true that the tax would not be shifted at all, but it certainly could not be so universally shifted. We shall see later when it may be shifted. If we had a tax system so arranged as to fall, in the first instance, upon all parts of each individual's income, — an unattainable ideal, — there could be but little shifting. But when a part of the nation's wealth is exempt, taxes upon all wealth that might be transferred into this exempt form are peculiarly liable to be shifted.

SEC. 5. We shall now look at the incidence of the

¹ There have been many theories which have undertaken to explain the final incidence of all taxation on some other plan than that of an examination of all the different taxes. Professor Seligman discusses ten different classes of theories in regard to incidence of which only two require this method. See *Shifting and Incidence of Taxation*.

more important taxes, taking them in the order of our previous discussion. Excise taxes and customs duties, so far as the latter yield a revenue and fall upon citizens of the country laying them,¹ are for our present purpose the same. They are classed by Professor Seligman as "virtually one form of the profits tax," which, "in the great majority of cases," will be "shifted in whole or in greater part." What Professor Seligman says upon this point² is true enough and very clear, but we shall follow a somewhat different analysis.

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In the case of these taxes it is the intention of the lawmaker that the tax shall be shifted to the consumer. If any of it remains on the producer or importer, it may be said to have been shifted back. This takes place sometimes: (1) if the taxed commodity is produced as a monopoly, and the price is already as high as the traffic will bear, *i.e.* the addition of the tax to the price would lessen the sale, then a part or the whole of the tax comes out of the profits of the monopolist; (2) a new tax on some commodity produced by a large plant of fixed capital, not easily transferable to other lines, may remain on the producer. In all other cases an excise or an import tax cannot be shifted from the consumer.

SEC. 6. The general property tax consists of a number of different parts which are best considered

¹ See Chap. VII. for shifting to foreigners.

² See p. 140 ff., and p. 177.

separately. Such a separation is legitimate since the tax falls apart in the practice of assessment. It falls naturally into at least two great divisions, a tax on real estate and a

*The incidence
of the general
property tax.*

tax on personal property. The tax on real estate may be regarded as of two parts, a tax on land and a tax on buildings. In the general property tax, the tax on land is assessed according to the selling value. When the land is used for agricultural purposes, the incidence of the tax lies between the owner and the user of the commodities produced.¹ Can the owner shift the tax to the consumer? If this happens, it means a rise in prices which again means an extension of the margin of cultivation, marginal lands being untaxed, as having no price, or less heavily taxed. But such a rise in price may affect consumption and lessen the demand at the same time that it tempts to the creation of a new supply, thus inducing a fall in prices. But as cultivators of land do not readily withdraw from their position, those on or near the margin of cultivation will suffer severely, but will generally hold on until their profits are gone, often until they are ruined. The conditions under which agricultural products are sold to-day are beyond the control of any one set of producers. The full burden of the taxes upon agricultural land, therefore, falls upon the farmers. In the

¹ For America, the tenant may be considered as a consumer of utilities, residence, etc.; so few farms, or productive lands, are rented that they need not be considered.

United States, inasmuch as the farmers are seldom the owners of any considerable amount of untaxed personal property, they bear far more than their proportionate share of the commonwealth taxes and often also of the local taxes.

In the United States the farmers are overtaxed.

When land is used for other purposes than agriculture, it is generally best considered in connection with the buildings on it. The incidence of the general property tax on houses and the land they occupy will vary from locality to locality with the demand for such houses and the supply. Houses cannot be readily torn down or fundamentally altered without great loss; consequently if the supply of rentable houses is larger than the demand, the tax on the buildings will fall wholly on the owner. It can be shifted to the tenant only when the supply of houses is very limited. In America these two cases are both frequently illustrated.

Incidence of a tax on buildings.

The incidence of that part of the general property tax which is assessed upon personal property or upon invested capital is very difficult to trace. If the tax were well and universally assessed upon all such capital, it could not, regularly, be shifted from the owner at all. There would then be no free field for this capital to invade. But when the tax is evaded by a considerable proportion of the capital, then the tax can be shifted to the borrower and will be so in the main.¹

The incidence on personal property.

¹ For the rest of this intricate subject the student is referred to the larger treatises.

It will be seen even from this brief statement of the facts of shifting concerning the general property tax that the incidence is different from the intended incidence wherever that tax fails of forming a complete system.

SEC. 7. The incidence of a land tax like the English differs somewhat from that of the land tax as part of the general property tax, inas-
The incidence of a special land tax. much as it stands entirely apart from the system. Still there are some points in common. Both these taxes may be capitalised. That is, the taxed property will sell for less than it would bring untaxed by the amount of the capital sum which, if put at interest, would yield the amount of the tax. In the case of the general property tax, which really falls upon well-nigh all land of any value whatever, the tax, as we have seen, falls most heavily upon the producer of agricultural commodities. But the English land tax has been capitalised and was paid for all succeeding owners by the owner at the time of its assessment, since it did not affect all lands and has become a fixed charge upon the property. The same is generally true of all taxes upon land which are in addition to a regular system of taxes, a part of which covers the revenue from land. The same may be said of a special building tax.¹

Special taxes upon certain forms of fixed capital, especially when they stand beside a general system

¹ See Seligman, p. 117.

which is fairly universal, may be capitalised in the same way. The incidence of taxes on profits is determined by the control which the recipient of profits has over the profits.

*Incidence of
special taxes
on capital.*

If the control is so great that he can virtually raise them at will, then he can shift the burden. But, inasmuch as it is generally true, that he is taking all that he can whether he be taxed or not, it is clear that he cannot as a rule shift them. Generally speaking, then, taxes upon profits are not shifted. A tax on successions, also, cannot in any conceivable way be shifted.

Poll or capitation taxes cannot be shifted at all. The only conceivable case in which they might be shifted is when levied upon a wage-earner at the point of starvation. The same is true of a tax on the lowest wages. The burden would mean higher wages in order for the labourer to live and meet the tax. But when the wage-earner is of a higher class, it is to be presumed that he cannot shift his tax at all, for that presupposes that he can control his wages sufficiently to raise them. If that were the case, we may safely assume that he would raise them whether the tax were imposed or not. He cannot therefore shift them at all.

*Shifting of
poll taxes and
wages taxes.*

A tax upon income cannot be shifted if the assessment is general and uniform. But as a matter of fact no such tax is general or uniform, and it will be shifted or not according as it splits up into other taxes upon rent, interest, wages, etc.

In conclusion : the intention of the lawgiver as to the incidence of taxation will be fully realised only, (1) when the system is theoretically perfect, and (2) when the execution of the law is perfect. The worst cases of shifting arise when serious gaps are left in the tax system, or when the administration of the system is so lax in parts as to result in a crippling of the whole. Shifting always acts to intensify existing inequalities. The problems of incidence are among the most important of our subject. The lawmaker may with the best of intentions work the greatest imaginable injury ; and the necessity for a careful study of the probable effects of each new tax cannot be overestimated.

CHAPTER XI

FEES AND INDUSTRIAL EARNINGS¹

SECTION 1. There is the closest sort of connection between fees and the industrial and commercial earnings of the State. In the case of the sale of goods or services by a State the private persons pay the price of the wealth which they obtain. The price is fixed by economic conditions. It cannot exceed a certain sum, for if it does, the citizen will not buy. But in most cases considerations of a public character induce the State to enter upon the industry or commercial enterprise, and these very considerations are inducements to a lowering of the charges. As the public element comes to be more clearly recognised, a part of the economic forces fail to act. The State sacrifices part or all of the gain, but makes no loss. As the public element presses still more to the front, the State pays, at the general cost, a part of the expense, and charges the particular persons specially benefited merely a fee for the service. Many modern public institutions have gone through a process of development from one stage to the other, and the different stages are found contemporaneously

¹ For definitions and classification, see Chap. II.

in different countries. But while this is the order of progression in new functions, it is not the historical order of the rise of these two forms of payment for public services. Fees are the older of the two.

Fees are not to be found in the ancient civilisations, because of the intimate relation between the individual and the State. Only when there is a distinct consciousness of "public" functions can we have fees.

Fees and the consciousness of "public" life. Payments in the middle ages for the services of the courts, of the church, of the schools, etc., were mainly of the nature of private remuneration. As soon, however, as any function comes to be recognised as public in character, fees arise. At first contributions are more or less freely and willingly rendered for the use of markets, roads, bridges, protection, and the like. Frequently there is an arbitrary assumption made that a special benefit is conferred and a fee is charged. As the State emerges from feudalism, the growth of public consciousness is marked by a rapid multiplication of these fees, which form a system of public revenues without taxes. After that the line of development is in the direction of the curtailment of the fee system and the growth of the tax system. Fees mark the transition stage in the division of labour in the public service. There is a growth of the conception of common benefits as distinct from special private benefits, and a corresponding removal of functions from one to the other category. At the same time new functions arise which are supported

by fees, until finally the recognition of public interest outweighs that of the individual interest. Some fees, however, become fixed in *Fees emerge* character and are not subject to these *into taxes.* transforming tendencies; but the public interest is recognised in this case by limiting the fees to a very small part of the total cost. Thus many court fees are retained, but the larger part of the rapidly growing expenditure for the support of justice is now met from taxes. Those functions, in connection with which there are fees, are regarded as conferring a divided benefit. The individual pays for what he receives, the State for what the public gains thereby.

SEC. 2. The extension of the fee system by the courts to cover a very large part of the cost of the judicial system, even to such a degree as *Judicial and* to make litigation impossible to all but *legal fees.* the rich, was a transition stage in the development from the middle ages to the present. Nowhere was the fee system for court costs more abused than in England. Later practice, while placing more of the burden on the general treasury, has retained an extensive tariff of such "costs." Moreover, in not a few instances, the assessment of the "costs" upon the party responsible for the litigation, as shown by the fact that he loses his suit, makes these fees approach in character punitive fines. This is the characteristic of American practice. In many cases the special benefit conferred is not

very clear, but is arbitrarily assumed to exist and the fee levied as though it were for such benefit.

Since the middle of the seventeenth century, a large part of many of the legal fees have been col-

The collection of fees by stamps. lected by means of stamps or stamped paper, the latter being necessary to legalise the transaction; the officer who

furnished or cancelled the stamp being supposed to investigate and vouch for the propriety of the transaction. A notary's fee in most of the American commonwealths is of this character, the fee being receipted for by a stamp embossed upon the paper. Similar fees or taxes on acts and transfers are very common in France. Other such fees are collected in the form of the sale of a license to perform certain acts which would not be legal without such a permit; and then there is a charge for recording the act after it has been performed in accord with the permit. Of this character are the fees for marriage licenses and recording of marriages. The act itself is, also, often subject to the payment of a tax. The general character of the legal fee is seen from the following list: fees for passports and similar papers of identification, fees for recording and legally recognising births, deaths, marriages, and divorces, changes of residence or legal standing, for papers in evidence of honours, degrees, orders, titles, offices, etc., for patent rights and copyrights, for consular services in vouching for invoices, etc.

SEC. 3. Many of the acts of the various adminis-

trative departments are of such a character as sometimes to confer a special benefit upon individuals for which a fee is charged. The police *Administrative fees.* may render extraordinary services as in the protection of property on special occasions, in the control of masses of people, preventing intrusion, etc. Examples of these special services are very frequent. The same is true of the special services of detectives for private persons.

Fees for public education are gradually falling into disuse. They were originally charged for all grades of instruction from the lowest up *Educational fees.* to the university. The importance of primary education to the general welfare of the people and to the prosperity of the State, when governed by popular franchise, led to the abolition of fees for that grade of instruction at a very early date. In England, owing to the prevalence of an extreme *laissez-faire* view upon this subject, fees for education were continued longer than in most countries, having only very recently been entirely abolished. In the higher grades, wherever such were in charge of the State, fees were retained much longer than elsewhere. The great universities of the American commonwealths have set the example of free tuition for their thousands of students, although they still retain a number of small fees for registration, diplomas, and certain incidental expenses connected with laboratory and similar instruction. European State universities

still generally retain the fee system for most of the lecture courses. Schools intermediate between those giving rudimentary education and the universities are generally managed without fees, like the lower grades. Educational functions of governments seem to have been going through the same transformation which roads have gone through. Already the larger part of the cost is met from general taxes and but a small part from fees. Finally the remaining fees will fall away.

In those countries in which the State supports the churches, or churches of a certain denomination, there are a number of fees connected therewith, such as those for the use of churches and churchyards, for baptisms, christenings, marriages, burials, confirmations, and communion. *Church fees.* The means for meeting the rest of the expenses are drawn from two sources. A part is sometimes taken from the general taxes or from special taxes collected for the purpose, and the remainder from voluntary contributions by the attendants, or from the sale of sittings and the like. This is the only important remnant of voluntary contributions in any part of the financial system. In most instances the voluntary contributions are for special purposes, organised charity, missions, etc., which are, perhaps, not properly considered of a public character.

The fees rendered by individuals in connection with their industrial and commercial enterprises are very numerous. The oldest and simplest are charges for

the use of market-places, later for the use of public exchanges, etc.; then come the charges *The fees for services of the State to private industry.* for statistics collected by public officers, and the charges for the use of bridges, roads, quays, etc. The modern substitutes for roads — railroads, canals, street railroads, omnibuses — are already passing from private into public hands, and the period of transition is marked by a more and more extended use of the fee system. Other means of communication — the post, the telegraph, and the telephone — are of the same character. Fees for coinage are also for services to commerce. They are in use by every country in some form or other. In the United States the charge for coinage was one-fifth of one per cent. England allows the Bank of England to make a similar charge when advancing notes upon bullion, and to set the price in notes for gold coin and gold bars. These fees must not be confused with the charges known as seigniorage, the latter being a tax upon commerce.

SEC. 4. One of the most important classes of fees is formed by special assessments. They are for some benefit to real property. A special assessment is a fee paid to cover the cost, less *Special assessments.* that of supervision by a salaried public officer, of a specified improvement to property undertaken in the public interest. In his excellent study on this subject Mr. Rosewater¹ tries to establish a difference between fees and special assessments. He admits

¹ *Columbia College Studies*, Vol. II., 3.

the similarity, but points out that special assessments *Special assessments are fees.* are restricted in purpose and in place, are apportioned among the members of a class, are assessed once and for all and for benefits to real property only. Professor Seligman makes the same distinction. But it is certainly not defensible on purely theoretical grounds, for the differences are not essential, but accidental. We might as well set up a separate class of taxes on marriages, for they are restricted in purpose, are assessed upon members of a class, once and for all, and are for benefits to the family only. Like all other fees, special assessments are imposed by the taxing power, cover both public and private benefits, and do not exceed the costs.

The simplest case of a special assessment is when a street is to be built, with necessary sewers and water-pipes. The costs of this have to be met. There is a public interest in the street as a thoroughfare. Private enterprise cannot be trusted to properly protect the public interest. The city, therefore, must step in. It could pay the cost from general taxes or from tolls, of both of which the specially benefited persons would pay their share. But in that case, temporarily at least, the abutting landowners would reap an unearned harvest at the expense of their fellow-citizens. It appeals to our sense of justice that they should pay for it. They can always afford to do so, as they gain by the improvement. This system has received

large currency in the United States, and has, according to Mr. Rosewater's extensive investigations, given general satisfaction.

Another method has been used to some extent in England. It is similar to that used by private speculators in America, when they open up a new city, or suburb. The city condemns and buys up enough of the land to be improved to furnish, when sold after the improvements, the funds needed. This method has a very limited application.

Special assessments are not frequent in Europe, but do occur. Mr. Rosewater finds them in varied form in France and Germany; and they are pro- *Special assessments not used in Europe.*
posed in England under the name of the "betterment" tax. In the last-named

country they were early applied to "walls, ditches, gutters, sewers, bridges, etc., damaged by the sea." But not until lately has the principle of measuring the tax by the particular benefit been applied or proposed, and even now the principle is not quite clear. In England the assessment is to cover the cost of the removal of injury rather than the cost of conferring a benefit. In England the cost of improvements is assessed in general taxes from which certain unbenefited districts are exempt. Strictly speaking, the principle is not regularly applied in England at all.

In the United States this fee finds almost universal acceptance. It is, indeed, remarkably well suited to the economic conditions of a new country,

and renders rapid improvement possible. In some parts of the country there are harmful results that arise from the desire to give property owners full control over the improvements for which such assessments are to be made. Thus, in some commonwealths, street improvements are only made with the consent of the owners of a majority of the property concerned. The result is that streets are opened irregularly, and some of the main streets are untouched, while side streets are improved. But this is an evil of expenditure rather than necessarily connected with this mode of collecting the revenue. The abuses of special assessments are few, and, on the whole, it is a part of the tax system of which America can be justly proud. Professor Bastable's criticism (p. 377) of these fees rests upon a misconception of the method of handling the assessments. They are assessed according to the cost of the improvements; the special benefit is the justification of the contribution, not its measure. There is seldom any difficulty in apportioning the cost fairly. No charge need be made for any additional benefit beyond the cost, and the contributor has, usually, a voice in deciding whether the proposed improvement shall be undertaken or not.

In view of the fact that the prevailing theory of taxation in this country is that which we have designated as the benefit theory, it is natural that Americans should have been the ones to have made

the application of the theory in this particular case. The special assessment is applied in just *Special assessments and the benefit theory.* those cases in which it is easiest to measure the special benefit. And although the principle cannot be given a wider application with any degree of satisfaction, it does, in this instance, comply with the demands of justice and equality. It would, moreover, be rather hard to find under the faculty theory any better justification.

SEC. 5. The post was included above among those functions for which fees were charged. Whether that be quite correct or not, depends upon *Postal fees.* the way in which the postal system is run. If it is run so as to yield the largest possible revenue over and above expenses, it is of exactly the same character as any other industrial enterprise upon which the State enters. The State sells postal services for the highest price it can get, or rather, for the largest net return. Its profits, the post-office being a monopoly, are regulated by the principle of charging what the traffic will bear. But no post-office is run on this principle. The importance of the public service rendered has led to the recognition of a large element of common benefit. This recognition has not resulted in the entire abandonment of charges for the service except in a few instances; for example, the free carriage of newspapers in the county in which they are published. But it has led to the attempt to run the service in such a way that expenses shall be met, and only a

small surplus, if any, shall accrue to the benefit of the treasury. Whenever the surplus tends to grow, the rates are lowered or the service improved. Of all the powers, Great Britain is the sole exception to this rule, about one-third of her postal receipts being profits. (1895, receipts £10,760,000, expenses £6,869,000. But the allied telegraph service ran behind; receipts £2,580,000, expenses £2,674,000.) The postal rates in Great Britain are as low as in other countries, but the surplus is accounted for by the extremely small size of the territory covered by the land service, the concentration of population, and the cheapness of water transportation, all of which makes it particularly easy to do a large and profitable business at low rates.

There are some writers who regard any surplus acquired in this way as practically the result of taxation, and class any charge for the public service, above the cost thereof, as a special tax. This classification presupposes that the service is, by nature, of a public character, an assumption contrary to the fact, for no function except that of governing itself, in the narrowest possible sense, is *by nature* of a public character, nor, on the other hand, *by nature* of a private character. On this consideration, therefore, it is better to class these gains, not as taxes, but as the earnings of a public industry.

SEC. 6. In modern times public industries can be quite as properly considered under the head of ex-

penditure as under that of revenue. Historically, State industries, like public or princely domains, lands, forests, and mines, were mainly sources of revenue. But a railroad is placed in the hands of the State primarily because of the public interests involved, and the expenditure for that purpose is more significant than the moderate surpluses that accrue, in some cases, to the government. For that reason we called attention to these activities under the head of expenditure. We have now to consider them as productive of so much total wealth, a part of which is immediately spent for the purpose which led the State into this activity, and a part, generally a very small part, saved to assist in the accomplishment of other purposes.

The oldest form of public property is land. The public land originally embraced all the territory of the State. Gradually parts of it were alienated to a private purpose subject only to the law of eminent domain; but considerable portions even to the present day belong to the State, or, what is the same thing, to the local governments. In the monarchies of Europe such lands were once considered the property of the prince. These lands were the main reliance for public revenues in the feudal State. As the people gained a voice in the government, they laid claim to these sources of revenue for public purposes. From that time on, the public domain diminished both absolutely, by sale

or alienation, and relatively as the wealth of the people swelled. Some countries adopted a very conservative policy in this respect, and retained their domains in land and forests, while others adopted the plan of steadily disposing of them. German states are examples of the former policy, while England, France, and the United States have been examples of the latter. England receives only £520,000 annually of "Woods, Forests, and Land Revenues of the crown." In the United States it was the possession of vast tracts of land by the federal government, acquired by gift from the commonwealths, and by purchase, which gave that government an independent territory over which its control was absolute, and formed one of its strongest supports, contributing most materially to the growth of federal influence. But the public lands have not been a source of revenue to the government. The money received from settlers has amounted to little more than fees for the registration of titles, and except for the ten years from 1830 to 1840 the lands have not yielded a clear revenue. The extensive surveys which the government carried out have been a large expense attributable to this source. Under constitutional government there is little danger of the failure of taxation as a permanent and regular source of revenue. So that public lands are not regarded as necessary for the integrity of the government. The retention of public lands in Germany and Austria is not explainable by any danger of the

failure of taxation, but by the greater tenacity of the older communistic idea. Democratically governed cities and towns cling to their lands as strongly as the royal governments. Prussia's public lands and forests yield about 50,000,000 marks annually after all expenses have been met. Cities and towns get as much more, and in many cases supply burgher families with wood without charge. In Russia the process of emancipating the serfs has changed the receipts from public lands into taxes, and left practically little revenue of the older character. In spite of the absence of constitutional government, Russia has gone faster in proportion to wealth and revenues, in the abolition of public domains than many German states. Russia's gross receipts from domains are about \$12,500,000, while Prussia's are nearly \$22,000,000. The alienation of public lands in Russia is recent, and it has progressed as that country advanced in civilisation.

Except when in charge of a highly trained body of expert officials, as in Germany, the public lands do not form a satisfactory source of revenue. They are not as a rule as well managed as similar lands in private hands. Forests form an important exception to this statement. A private owner cannot afford to wait long enough for economical use of timber land. The destruction of forests at private hands is a serious danger. Only a permanent, long-lived institu-

No reason for the retention of public lands to-day.

Public control of forests a public necessity.

tion like the government can take proper care of forests.

Closely allied with the public ownership of lands and forests is the public ownership of mines. This is one of the oldest State industries, which is of late falling into disuse. The work-
Ownership of mines. ing of mines by the government is being replaced in Europe by a system which allows of private operation, but guarantees the public interest by the collection of royalties, or mining taxes. In the older countries, where the idea of public territorial ownership is stronger, the old system still prevails, and, even where it is partially surrendered, the revenues derived from royalties and taxes are proportionately large. But in the new countries of the American continent and Australia private ownership generally prevails, and no more revenue is derived from this source than from any other taxed industry. The feudal idea of territorial ownership, a remnant of which still survives in those countries of Europe which retain their interests in the mines, is very different from that of private ownership in fee simple as in America. This accounts for the difference in the revenues from this source.

SEC. 7. But while the modern State has surrendered the extractive industries, a great many others have been undertaken, not so much as
Other industries. sources of revenue as because of the importance of the public interests involved. Before the nineteenth century the most striking instances are of

the production of some commodity needed for the public service or of articles of an artistic and costly character. Examples of the latter are the Gobelin tapestries and the Sevres ware. In supplying arms, forts, vessels, public buildings, and the like there is no uniformity of practice among the nations. In only a few cases is the method regularly that of government production. There is a similar absence of uniformity in practice in regard to all those industries which involve large public interests for the conservation of which there is under private management no good guarantee. In some cases, as the water-supply, there is a general tendency in the direction of public ownership. Whenever, as in this case, a public interest is absolutely paramount to every other consideration, there is little attempt to make the industry a source of revenue beyond what is necessary to maintain the service. These industries, therefore, tend rapidly to be supported by fees or taxes. Inasmuch as it is generally the importance of the public interest that led to the assumption of the industry by the government, this tendency is universal. Roads, canals, the water-supply, the post-office, telegraph, telephone, and the railroads all pass more or less rapidly through these stages according to the importance ascribed to the public interest in them. As already seen, the post-office is now primarily supported by fees. The funds for the support of waterworks are generally collected from the users, as fees, or from certain classes of persons as special taxes, but seldom as

prices for the service. The experience of nations with State-owned railroads is too recent and too varied to be very instructive. States have been led into the ownership and operation of railroads : first, because the roads needed the support of public credit ; second, because of military interests ; third, because of the failure of private companies to protect public interests. Railroads have more often been a source of public expenditure than of public revenue. In Prussia alone have the financial results been such as to add materially to the income of the treasury. The question of government ownership of railroads is one involving considerations broader than merely fiscal ones, and does not properly belong to our subject. In no case is it at all likely that merely fiscal considerations will have more than a deterrent effect upon the solution of the problem of the government's action in regard to the management of the railroads.

While the industrial, commercial, or other economic functions of the State are of continually growing importance, they are not likely to be largely a source of net revenue. No-
Public industry not likely to be a source of net revenue. where do we find principles that would lead us to anticipate that revenues of this character will ever supply the place of taxes. Indeed, if the usual evolution continues, these functions may be performed by the State without a special charge upon the benefited persons, and, while the liberties of the people in respect to the enjoyment of these facilities will be greater, the burden thrown upon

general taxation will be equally so. If a city now supplies a sewer system to citizens free of special charge except for first construction, it may with the same logic supply water. If a State furnishes roads at common cost, it may certainly so far modify the management of railroads as to apply the fee system and forego the collection of any surplus, though in this case, as in that of the post-office, there would seem to be as yet no sign of any tendency to go beyond the fee system.

PART III

PUBLIC INDEBTEDNESS

CHAPTER I

THE GROWTH AND NATURE OF PUBLIC CREDIT

SECTION 1. The national governments of the civilised world owed in 1908-1909 more than thirty-six and one-half thousand millions of dollars, *The size of public debts.* or seven and one-half thousand million pounds sterling. With the addition of the debts owed by the local governments this sum will exceed forty thousand millions of dollars, or eight thousand million pounds. The nearest available figures are:—

National debt of all countries, 1890 . .	\$27,524,976,915
National debt of all countries, 1908 . .	36,548,455,489 ¹

According to the best available authorities the national indebtedness of the world increased four-

¹ Bastable, in his edition of 1903, says that the total of national debts can hardly have been less than £7,000,000,000 at the close of the nineteenth century (p. 626).

fold between 1848 and 1890, and by 1908 it was fivefold.

Years	Aggregate debt	Increase	Per cent of increase
1848 . .	\$ 7,627,692,215		
1860 . .	10,399,341,688	\$2,771,649,473	36.34
1870 . .	17,117,640,428	6,718,298,740	64.60
1880 . .	27,421,037,643	10,303,397,215	60.19
1890 . .	27,524,976,915	103,939,272	.38
1908 . .	36,548,455,489	9,023,478,574	32.80

[From best available sources.]

The increase of national indebtedness between 1880 and 1890 was comparatively slight. But this was partly due to the payment of a large part of the national debt of the United States. The increase since 1890 is largely attributable to the Boer War in England and to the Spanish-American War. Other countries have continued the process of debt-making—although less rapidly, owing to the continuance of peace. The above figures do not include pensions, which are really debts in the form of annuities.¹

The following table compiled from the Statesman's Year Book for 1906 gives the details of the population, indebtedness, and *per capita* debt on the account of the national governments only, of twenty-four of the most important nations.

¹ If these were included and capitalised at ten years' purchase, which would, perhaps, be a fair average, they would add to the debt of the United States at least \$1,500,000,000.

REPORTED NATIONAL DEBT OF SPECIFIED NATIONS FOR THE
FISCAL YEAR, 1904-1905

COUNTRY	POPULATION	TOTAL DEBT	PER CAPITA DEBT
Austria	26,150,710	\$ 785,243,792	\$ 30
Hungary	19,254,560	1,069,067,854	56
Austria-Hungary . . .	45,405,270	1,095,606,825	24
Belgium	7,074,910	606,762,617	86
Bulgaria	3,744,280	66,162,890	18
Denmark	2,464,770	65,269,644	26
France	38,961,950	5,929,395,672	152
Germany	60,605,180	823,290,138	14
Greece	2,433,800	164,001,050	67
Italy	33,476,120	2,424,448,935	72
Netherlands	5,509,660	464,246,824	84
Norway	2,240,100	71,657,217	32
Portugal	5,423,130	855,114,614	158
Roumania	6,400,000	264,723,487	41
Russia	129,309,300	3,738,394,688	29
Servia	2,676,990	89,736,313	34
Spain	18,618,100	1,858,191,268	100
Sweden	5,260,810	103,803,418	20
Switzerland	3,425,380	19,798,382	6
Turkey	24,028,900	537,767,716	22
United Kingdom . . .	43,218,000	3,877,318,133	90
United States	81,511,815	989,866,772	12
China	407,253,000	587,654,208	1
Japan	46,732,200	483,942,912	10

The totals for the British Empire are: population 325,540,000, total indebtedness \$7,190,748,566 (£1,440,000,000), *per capita* \$22 (£4 10s).

While the absolute amount of the debt has in-

creased, the burden has materially decreased since 1880, owing to the increase in population and wealth. In 1880, the national indebtedness of countries other than the United States amounted to \$35.64 *per capita*, while in 1890 it was \$32.90 *per capita*. During the same period the national debt of the United States was reduced absolutely by over a billion dollars, and relatively from \$38.33 *per capita* to \$14.24 *per capita*. The *per capita* debt for the world at large on the national accounts only was in 1909 about \$26, that of the United States in the same year about \$10. Of course statistics of this sort are neither perfectly accurate nor easy to interpret. The only proper comparison between different countries would be that of the ratio of the interest charge to the annual income of the people. But the annual income is very difficult to ascertain, and the errors would, probably, be so great as to destroy the significance of the result. But the foregoing figures, while not absolutely correct, are sufficiently so to indicate that the policy of borrowing has become a most vital part of the system of public finance. The cause of the national debts is almost exclusively war and the preparation for war. If the expenses of war and its preparation had been excluded from their finances and the treasury relieved of the subsequent burden of interest, civilised nations would have been easily able to meet their current expenses. In England the annual public-debt charges for interest and debt payments

*The burden
has decreased
since 1880.*

consume nearly one-fourth of the annual revenues from every source. The policy pursued by England is to fix a permanent debt charge against the annual revenues and to use all that can be saved therefrom over and above the interest charges for the payment of the principal. This so-called sinking fund system is suspended in time of war. The funded debt of France, the largest ever contracted by any country, imposes an interest charge of about 1,250,000,000 francs upon a total revenue of about 3,500,000,000 francs. If we include certain annuities and pensions, over one-third of the revenues of France are consumed in this way.

Germany is the only country of importance that does not rely entirely upon the possibility of borrowing money in case of war. That country maintains a special cash reserve of \$30,000,000, which is available for immediate application to war purposes, should it be needed. Although the German Empire began in 1871 without debt, it had in 1908 a debt of 1,588,000,000 marks. This is largely due to armament. So that, although Germany holds a cash reserve for military purposes, it is practically a borrowed one, and she is making her preparation for war on borrowed money. This policy does not differ essentially from that of other countries. In the middle ages, however, as in classical times, it was the practice of nations to accumulate a treasure for war purposes in advance, by collecting more revenue each year than was needed. This prac-

*Germany's
cash reserve.*

tice is now obsolete and is also indefensible as too costly.¹

Modern nations, then, practise a method of deficit financing. They make provision in their annual revenues for the current, regular, or *Deficit financing* "ordinary" expenditures only, and rely *for funds at other times upon their ability to borrow.* What then constitutes this ability to borrow upon which so much reliance is placed that even the very existence of the nation is allowed to depend upon it? Since when, and how is it, that nations have been able to rely so absolutely upon public credit? The answer to both these questions is contained in the analysis of public credit.²

SEC. 2. Public credit is only one form of general credit, and it is comparatively easy to point out wherein the former differs from the latter. But credit in itself is by no means *Public credit a form of general credit.* easy to define. Scarcely any two of the able writers who have treated the subject are agreed as to its most important features. It has, moreover, as a term in common use, suffered so *Difficult to define credit.* many subtle changes in meaning in the course of its history as to leave its modern signifi-

¹ See Bastable, p. 567.

² The first edition of this work was severely criticised for containing the analysis of public credit that is reëmbodied in this edition. It may well be that a study of credit is more appropriate to a work on economics than to one on public finance. But the finance minister of every nation is necessarily vitally concerned about the credit he can command, and, appropriate or not, the subject is of vital public importance in a fiscal relation.

cance full of dangerous variations. The ordinary business man uses the word daily to convey half a dozen or more different ideas without recognising the differences. Scientific writers have waged long and bitter controversies concerning its proper definition.¹ Without going too deeply into the controversy, we may say that there are practically three opposing views as to the real nature of credit. First, there are those writers, who, like Nebenius and Rau, start from the etymological meaning of the term and maintain that the confidence, or trust, reposed by the creditor in the ability of the debtor to fulfil an agreement in the future is the chief element in credit.² Second, there is a class of writers who, like Knies, regard this element of confidence, a mere psychical condition, as too intangible, too immaterial, to be of any value for a scientific definition. They proceed entirely from observation of those transactions which are said to involve the use of credit, and find in all such transactions one feature which is never present in transactions not designated as credit transactions. That feature is that the completion of the transaction is regarded as being postponed to a future time. This element of time, this postponement, must then, they argue, be the essence of credit. Credit is, in their

¹ A good idea of the extent of the controversy and of the conflicting views can be gained from Knies, *Der Kredit*, Berlin, 1876.

² Nebenius, *Der öffentliche Credit*, Carlsruhe und Baden, 2d ed., 1829; Rau, *Finanzwissenschaft*, 3d ed., Heidelberg, 1851; II. Abt., p. 248.

eyes, merely a means of transferring ownership temporarily, a means of paying for present goods with a greater quantity of future ones. Third, there is still another school, who, like McLeod, regard credit as analogous to money, money being regarded as representing claims on the wealth of the whole community, while a credit is a similar claim on the wealth of some particular individual. McLeod even goes so far as to identify the claim, the order, the promise to pay, or the right to demand with "the credit." "A credit," says McLeod, "in Law, Commerce, and Economics, is the Right which one Person, the Creditor, has to compel another Person, the Debtor, to Pay or Do something."¹

SEC. 3. These definitions, apparently so contradictory, are not altogether irreconcilable. They represent different points of view rather *Reconciliation* than real differences in meaning. Cer- *of these views.* tainly nothing but credit is described by any one of the three definitions, and certainly there are shades

¹ *Theory of Credit*, Vol. I., p. 315. In a very scholarly article published in the *Quarterly Journal of Economics*, January, 1894, Professor Sherwood discusses the nature and mechanism of credit in a way to throw a great deal of new light upon the subject. I do not believe that his analysis can be improved upon. He distinguishes particularly the credit basis of money, as generic or universal credit (which he calls "customary credits"), from that of the commonly so-called credit transactions, which he calls "formal credits." It is with the latter only that we are concerned here. They are legally enforceable. They rest in the economic sense "on a psychological trait of faith in the uniformity and reasonableness of other men's voluntary acts."

of the meaning of the term that are aptly described by each of them. As is so often the case when a word in common use is defined for scientific purposes in several ways, we find that one definition fits certain classes of things covered by the term better than others. There are certain debts, for example, in which the element of trust is paramount, others in which that of time is more important, and again some in which the element of claim or demand is the distinguishing thing. But it is also true that there are no cases of the existence of credit where all three of these features do not appear, the one or the other varying in importance as the case may be. To fully understand a thing so many-sided as credit, it is necessary to examine it from several points of view.

If we start from the etymological meaning of the term, we cannot avoid the conclusion that one of the chief elements of credit is trust. Certainly without that intangible, unmeasurable feeling or frame of mind known as confidence, trust, or faith, on which Knies pours so much scorn, no debts would have come into existence.

Confidence a necessary part.

As Professor Cohn well says, "Credit rests on the development of opinions and institutions which arise with the general advance of civilisation."¹ Modern usage has not yet eliminated this original meaning from the term. It cannot be altogether incorrect to make this a part of the defi-

¹ *Grundlegung*, p. 553.

nition. It is customary enough to conceive that credit or faith is reposed by the creditor in the debtor, and that it varies in amount, although never exactly measurable. But there are many credit transactions in which the element of trust shrinks into insignificance. An advance on a warehouse receipt, a Lombard loan, a pawnbroker's advance, all of these and many like them are credit transactions, but the element of personal confidence plays little part in these. The creditor in these cases never has to consider the character of the debtor nor his ability or willingness to pay. After he has satisfied himself as to the value of the security, all that he has to consider is the time the *Time also* debt has to run. It must be admitted, *essential.*

then, that there are a number of cases of credit transactions in which the paramount element is that of time. The first two of the above-stated views of the nature of credit are, therefore, reconcilable in this way. They may be regarded as essentially the same with a difference in the emphasis, and it is correct to change the emphasis when different kinds of debts are considered. Both of them may be covered by one definition, which may for two reasons be called the subjective definition: (1) because it takes into consideration feelings, opinions, *i.e.* trust, confidence, belief; (2) because it looks at credit from the natural point of view of the creditor who entertains that trust.

Subjective Definition. — From the subjective stand-

point credit is the confidence or trust reposed by one person in the ability of some other person to fulfil a promise at some future time. The emphasis will fall upon the feature of trust or upon that of time according to the nature of the particular debt in point.

But that is not all: we have yet to dispose of that view which identifies credit with the claim which the creditor has on the debtor. In one aspect this view seems absolutely contradictory to that which we have adopted. So much so that Knies ridicules it, considering it quite as absurd as the reasoning of John Law. He says it makes the debtor give credit: *i.e.* he gives the claim, and the claim is credit. But McLeod's reasoning is not so easily disposed of. He has taken what may be *The objective point of view.* well called the objective view. He has sought out embodied credit. His, too, is the natural point of view of the debtor. The opposition, therefore, between the two views is more apparent than real, and arises from the fact that each is from a different point of view. There are two sides to the shield. The debtor sells a claim (a chose in action) which is a more or less tangible thing having a present value, just as many another right has; as, for example, a patent right or a copy-right. The debtor is concerned only with the value of that claim. The creditor, however, looks beyond the claim and desires to know whether he can trust in the ability of the debtor to make the claim good.

By a very natural analogy, too, the language of business says that the debtor enjoys good or bad credit, as though the trust reposed in him by others, in whose minds it exists, really became an attribute of him. There is still more ground for McLeod's view, for, as has already been remarked, it is often the nature of the claim created that adds to, or detracts from, the credit. Any man, in ordinary times, can obtain credit, if he comes prepared with collateral security and is ready to create a claim that is good on that in case his other resources fail him. It is clear, then, that the view of McLeod is important, and also that it is supplementary to that already adopted. It reveals many phases of credit that cannot be seen at all from the subjective point of view. The two views taken together make a complete explanation.

Objective Definition.—From the objective standpoint, credit is embodied in claims which are accepted by the creditor in payment. These objective claims have a value like every other exchangeable commodity, and are recorded in the various "instruments of credit."

If these two definitions are accepted, we can proceed to point out wherein public credit differs from ordinary or private credit. The peculiar conditions which distinguish public credit from ordinary credit arise from the fact that the debtor is the State. The State, being above the law, cannot be compelled, as the

*Public credit
differs from
ordinary
credit.*

private individual can, to pay its debts. Public credit is therefore subjectively defined as the confidence or trust reposed in the ability and willingness of the debtor (the State) to fulfil its promises at some future time. Objectively the claim (in this case the bond) shrinks to the character of an unsupported although generally accepted promise. There are, to be sure, some important cases in which the claim is apparently supported by something more definite than the mere promise of the debtor; as, for example, when the revenues from certain productive enterprises are pledged for the support of the debt charges. But even in these cases, the creditor has no real resource against intentional bad faith. In general the subjective standpoint gives a better view of public credit than the objective, because the claims cannot be enforced.

The fact that the debtor is the State has other important consequences. (1) The State has sovereign power and can compel its subjects to lend to it; or, on the other hand, the creditor may make advances on rather poorer terms than he would otherwise accept, from motives of patriotism. (2) The debtor State lives forever, and hence can make perpetual debts. (3) Its affairs are all open to inspection, and the would-be creditor has full opportunity to know its ability to pay. (4) Public credit may be divided into various parts, according as it is the credit of the central government or of some subordinate depart-

Other differences between public credit and private.

ment that is being considered. The consideration of the relations of the different parts of the government in this respect belongs to the field of public law rather than to that of public finance.

SEC. 4. Public credit was necessarily later in development than private credit. General habits of lending on a large scale had to be established before nations could borrow. *The late development of public credit.* The bankers and brokers of the world had to develop the machinery for handling evidences of debt before large public loans could be placed. Then, too, inasmuch as the objective evidences of debt in the case of the government were nothing but the unsupported promises of the government, confidence that these promises would be kept had to grow. At first the assurance rested on the honour of the monarch, or upon some pledge or security given by him, such as the crown jewels, crown lands, a lease of the revenues, and the like. But later, as Bastable so ably shows,¹ the development of public credit goes hand in hand with the development of constitutional government. It would seem that the control of the purse by the very persons who were to pay the taxes gave a steadiness and security to the financial administration that aroused the confidence of money owners.

SEC. 5. Much attention has been given by different authors to the economic effects of public borrowing. It is now pretty well agreed that public

¹ P. 579.

borrowing does not, as was once taught,¹ create new wealth except indirectly, through the use made of the capital taken when it is used productively.

Nor, on the other hand, does public borrowing in itself directly destroy wealth. *Economic effects of public borrowing.* The money borrowed may be devoted to some form of rapid consumption, as in war. In this case the destruction of wealth is determined by the line of expenditure decided upon, not by the borrowing merely. But the feasibility of obtaining large sums in this way is said to lead to more extravagant expenditure than would otherwise be indulged in, since taxation for such purposes would be difficult. The consumed wealth is replaced by claims upon future wealth which are not of such a character as to be available as productive capital. But the loss incurred is distributed over many years instead of being concentrated in a few. As in the case of a spendthrift who mortgages his patrimony for wasteful extravagance, so in the case of a nation which borrows for war, the evil that arises is from the waste of war, not from the borrowing. For a State to borrow for a productive purpose has no other economic effect than for a private corporation to do the same.

SEC. 6. There has also been some discussion of the relative merits of domestic and foreign loans, and their differing economic effects. Sometimes it has been claimed that foreign loans involve less

¹ "The public funds a mine of gold."

disturbance of domestic industry. The intimate relation existing between modern nations in their commercial and industrial enterprises destroys to-day almost all the significance that might formerly have been attached to such a discussion. The payment of the French indemnity of 5,000,000,000 francs to Germany after the war of 1870 was carried out in twenty-seven months, and not one single serious difficulty or disorder in the financial centres was produced by it.¹ So great is the mobility of modern capital and so vast are the current transactions, that all of this money could be easily turned into the same stream without disturbing its placid surface.

Public credit is a plant of slow growth; more than that, it is a delicate plant. It may be injured beyond recovery by a single case of failure to fulfil the promise in which it found expression. Many of the commonwealths of the United States have repudiated their debts, and have since then recovered their power to borrow but slowly, and in some instances scarcely at all.² Weak nations which may be or have been coerced by stronger and wealthier nations in the interest of

¹ *Blackwood's Edinburgh Magazine*, February, 1875, pp. 172-187.

² Under the Eleventh Amendment to the federal Constitution, a state cannot be sued in a federal court. This is contrary to the original intention of the Constitution. See my monograph, *Das Kreditwesen der Staaten und Städte der Nordamerikanischen Union in seiner historischen Entwicklung*, Jena, 1891. Egypt is a good example of foreign coercion to enforce debt payment.

citizens of the latter who were creditors of the former, generally borrow more easily than stronger independent nations, or parts of strong confederations, which have failed to meet their obligations and cannot be coerced.

The credit of local governing bodies depends in great measure upon their powers and duties in public law. Generally speaking, a "municipal corporation," when acting legally within the sphere prescribed to it, is like a private company,—its obligations can be enforced by legal or judicial procedure. Unlike the sovereign State, a municipality can be sued without its consent. Only with the positive sanction of the sovereign State can a municipality default and escape punishment therefor.

CHAPTER II

FORMS OF PUBLIC DEBTS

SECTION 1. Governments may borrow money in almost any of the ways which an individual may use. These different forms can be best made clear in connection with their classification. The principles upon which a useful classification can be built are those

Classification should show the credit upon which each debt rests.

developed in the preceding chapters. Public debts are forms of public credit, and the kind of credit upon which each debt is based can be shown in the classification. Some light can be thrown on the different forms of debt by a review of the older classifications. One of the commonest distinctions is that between funded and floating debts. Originally, this distinction was very simple, and correspondingly useful. In the words of Adam Smith : " Nations, like private men, have generally begun to borrow upon what may be called personal credit, without assigning or mortgaging any particular fund for the payment of the debt ; and when this resource has failed them, they have gone on to borrow upon assignments or mortgages of particular funds." The first of these is the unfunded debt, the other is the funded

Funded and unfunded debts.

debt.¹ But although these terms are still in common use, the meaning attributed to them has so entirely changed, that to-day the so-called floating or unfunded debt consists, in large part, of outstanding claims upon very definite revenues, while it is often the case that no particular fund or source of revenue is directly pledged for the payment of the so-called funded debt. Hence it is that Professor Cohn treats Smith's grounds of distinction as antiquated, and says that the real distinction is found in the fact that the funded debts are those of longer duration, and the floating debts those of shorter duration, "although," he adds, "different causes and purposes of credit lie behind the difference in duration."² The most elaborate attempt

to explain the modern use of these *Wagner's distinctions.* terms is that of Wagner. As it is so complete, it is well worth summarising here. Funded and floating debts can be distinguished by the following characteristics, which are more or less clearly recognisable in the different cases: (1) the purpose of the loan — floating debts are generally for rapidly passing needs, especially for the payment of the current dues of the treasury: funded debts are to supply the capital for permanent needs of the civic household; (2) continuance of the debt — together with the former characteristic, relatively shorter continuance of floating debts, at least in intention;

¹ *Wealth of Nations*, Bk. V., Chap. III.

² *Finanzwissenschaft*, p. 757.

longer continuance of funded; (3) the legal conditions of repayment — in the case of floating debts the different items are repayable at sight or within a comparatively short period; in that of the funded, the creditor has a more limited control over the principal, the debtor (the State) being bound to repayment according to a fixed plan for amortisation, or making no agreement as to the repayment of the principal. This last is regarded as the essential test.¹

The difficulty found in drawing a sharp line between these two classes arises from the fact that the distinction is at best purely an arbitrary one. It may differ from state to state, or from time to time in the same state, according to the temporary whim of the public official or statistician. The terms are relative ones. By a floating debt is generally meant one that is regarded by the person using the term as a temporary one. One official will call any debt temporary, or a floating debt, which has three, five, or even ten years to run; while another will refuse the term to any debt that is to run longer than six months or a year. Strictly speaking, the term "floating debt" ought never to be applied to any debt that is, on the face of it, to run beyond

¹ Most writers make use of these terms; few have defined them so accurately as Wagner. For example, Adams, *Public Debts*, p. 147, concedes the term "floating debt" only to those in which the government retains the right to investigate each particular claim. This necessitates a new class of "temporary debts," consisting of treasurer's notes, bills of exchange, and the like.

the end of the fiscal year next succeeding that in which it is created. But there is no established custom for such a limitation. In trying to draw a sharp line between these two classes, we meet with the same difficulty that we met in attempting to distinguish between direct and indirect taxes. But we have even less to go upon. Official, statutory, and scientific usage varies so much that nothing is gained by attempting to collate all the meanings. Even for the most general scientific purposes, therefore, these terms are of little value, and for the purposes of classification the distinction is absolutely useless.

SEC. 2. There are two, and only two, ways in which a State may borrow. It may compel persons

*Forced loans
and contrac-
tual.*

to lend to it, or it may offer terms to which persons agree. The first of these will be called, for convenience, forced loans; the second contractual.¹ This distinction into two classes according to the motives appealed to is primary. The first class consists of loans that are now comparatively unimportant and rare. They were once more common.² Few nations now have resort to forced loans, even to the limited extent of

¹ Leroy-Beaulieu, Adams, and Bastable make use of a third class called "patriotic" loans. They have three classes, forced, patriotic, and "voluntary." The need of this second class is not clear. The patriot differs from the other creditors only in that he accepts worse terms, or apparently such. Unless he waive all claim to repayment, in which case there is no debt, his loan differs from those of the third class only in that it is even more "voluntary."

² See Roscher, § 132.

paying their current expenses in bonds, and compelling persons having claims to accept them. There is a form of quasi-forced loan, that is of some interest. That is the use of irredeemable paper money. This is very commonly spoken of as a forced loan. It must be observed, however, that it is a loan only when the government making such issues, directly or indirectly, promises to redeem the notes at some future time. Otherwise no debt has been created. When such money is issued with the purpose of retaining it in circulation permanently, it is not, in intention at least, a debt; but it is a form of forced payment more akin to a tax. Even when there is a promise to redeem the money at some future time, this forced loan shows few of the fundamental features of a debt. Every debt involves the use of credit.¹ Now from the subjective side there is little or no credit involved in this case. The trust or confidence amounts to nothing more than a belief in the stability of the government and a readiness to obey its authority. From the objective side the creditor, if we may call him such, receives a claim that is satisfiable not from the goods of the debtor as in other cases, but from the goods of the community, and that by law. Unlike money of "final redemption," these notes cannot properly be said to be based even upon customary credit. From both points of view, then, these so-called

¹ Formal credit, to use Professor Sherwood's term; see note, p. 373.

forced loans are scarcely more than quasi-debts. They are also quasi-taxes. Dietzel maintained that these loans were merely taxes.

SEC. 3. Among the contractual debts the first thing that strikes us is that certain of the contracts contain features especially intended to add to or insure the confidence of the creditor, while in others there is little or nothing looking to that end. This at once suggests two natural subdivisions of con-

*Divisions of
contractual
debts.*

tractual debts. On the objective side the first class consists of claims good (1) upon particular funds, or (2) upon particular revenues or the revenues of a particular period, or (3) upon certain definite portions of the general revenue permanently set aside to meet them. These three bases for the claims suggest three natural subdivisions of the first class. Of these three again, the second, consisting of those claims which bear upon certain definite revenues, may be most conveniently analysed according to the classification that was adopted for public revenues.

The most important element of those debts, the contracts for which contain no provisions directly intended to insure the confidence of would-be creditors, is the length of time that the debt has to run, or, what is much the same thing, the relative size of the demands made thereby on the general revenue. Here we find that certain contracts call (1) for the repayment of the principal only, some (2) for the payment of principal and interest, while others

(3) call for the payment of interest only. To shorten the matter, the whole classification will now be presented in the form of a table. The names of the classes are generally self-explanatory, but in some cases, for clearness' sake, a concrete or a general example is appended.

I. FORCED DEBTS: (Now mostly obsolete. Akin thereto are the quasi-debts in the form of irredeemable paper money.)

II. CONTRACTUAL DEBTS:

A. The contracts for which contain provisions directly intended or calculated to insure additional confidence. Such confidence resting:

1. On the fact that the sums received from the creditor are not expended but are retained to meet the debt charges.

These are of two kinds:

a. Voluntary deposits:

- 1) Without interest. Ex. Post-office orders.
- 2) With interest. Ex. Deposits in public banks, etc.
- 3) Insurance (not compulsory).

b. Statutory deposits:

- 1) Guarantee funds of various kinds, with and without interest. Ex. Deposits by insurance companies to protect policy-holders, etc.
- 2) Insurance (compulsory).

- 3) Deposits of coin or bullion to secure circulating notes. Ex. United States silver and gold certificates.
 - 4) Estates in hands of the courts pending litigation.
2. On the fact that definitely specified revenues are set aside for the payment of the debt (subdivided according to the classification of revenues).
- a.* Based generally on the revenues of a definite period. Debts contracted in anticipation of the revenues. Ex. chequer bills and redeemable notes.
 - b.* Based on prices or rates. Ex. Money borrowed for the establishment of some productive enterprises carried on in a manner similar to private enterprises of the same character.
 - c.* Based on fees. Ex. Some Municipal bonds for waterworks.
 - d.* Based on special taxes:
 - 1) By the method of farming taxes (now obsolete).
 - 2) By appropriating special taxes (or a percentage of all taxes), and putting the funds thus received into the hands of trustees, for the payment of the debt.

B. Where confidence is so assured that no special means are taken to arouse it. Classified according to the thing promised:

1. Principal only. Ex. Redeemable notes (money) not legal tender, and not assured by any deposit.
2. Principal and interest:
 - a. Bonds sold in the market for what they will bring, and bearing a fixed rate of interest, payable at a set time or in instalments.
 - b. Annuities, terminable at the end of a definite or indefinite period, as a term of years or a life, so calculated that at the end of the period the amount paid shall equal the principal and interest. These may be in many different forms; they may be arranged in the form of life annuities, of pensions, of lotteries, or in that of tontines and the like.
3. Interest only:
 - a. "Perpetual bonds," in the case of which the creditor has no right to demand the payment of the bond within any definite period, but the government may generally, after a fixed time has elapsed, redeem the bonds for a stated sum.
 - b. Permanent annuities.

SEC. 4. In the great majority of cases in modern times, the leading nations are able to borrow without particular reference to any special means of arousing confidence. The long period through which they have faithfully fulfilled all their obligations has so thoroughly established their credit that

Means of alluring creditors. their bonds stand among the best securities on the market. The only changes that can be made in these debts are such as are intended to make the annual burden as small as possible. Some of the things desired by creditors, and which, while not affecting the credit of the borrowing State, yet add to the readiness with which the bonds sell, are (1) that the debt shall not be redeemed arbitrarily for a capital sum which would not yield, at the market rate of interest, the same annual income as the bond; (2) that any chance gains that may arise, as from a fall in the market rate of interest, may, for a time at least, accrue definitely to the holder.

By far the larger part of European debts consist of the so-called "perpetual" bonds. These bonds, "*Perpetual*" which generally name a certain capital sum at which they may be redeemed, contain no date at which they mature. They are redeemable whenever the debtor (the State) chooses, subject in some instances to certain limitations for the greater security of the lender; for example, the publication of notice of intention to redeem or promise not to redeem for a certain period. These "per-

petual" bonds are for both parties a very convenient form. What they amount to is that the State sells an annuity for what it will bring, with the privilege of redeeming it at any time for a certain sum, but it cannot be compelled to redeem it at any inconvenient time. The creditor, owing to the publicity which to-day attends all public affairs, knows what provisions can be made for the repayment, and consequently knows approximately how long his annuity will run. He can, moreover, easily dispose of it through the stock market if he should need the money for other purposes.

This form was once used in the United States, but traditions of rapid payment led to the adoption of different forms.¹ The first debts of the United States had been made in the form of simple perpetual bonds with no limits.

*Early debts
of the United
States.*

The debts created after the War of 1812 were also of that variety, with a limit of time set within which it was promised not to redeem them. But the variation just referred to was introduced in 1862. This form has been called the "limited option" debt. The bonds were "redeemable at the pleasure of the United States after five years, and payable twenty years from date" of issue. They were called "fifties." A similar plan was followed in the so-called "ten-forties." The only advantage gained by thus fixing a limit at which the creditor is to expect the payment is that the fiscal officers may have a

¹ See Adams, *Public Debts*, p. 162.

definite goal toward which to work. If a termin is set, it is easy to urge the extinction of the debt at or before that time, and consequently the adoption of special means and efforts toward that end.

SEC. 5. Next in bulk are the "terminable" annuities. These may be terminable at the end of a certain period or at the death of the holder. "*Terminable*" annuities. Life annuities, both upon individual lives and upon the tontine plan,¹ are old favourites. But as forms of original loans they are giving way to the perpetual bonds. Life and other terminable annuities have the advantage of affording an easy means of debt payment; and in this respect, on account of the accurate knowledge of the amount to be paid, those terminating at a definite time are the preferable. But inasmuch as the annual payments must be larger than the interest by an amount calculated to equal the principal or cost at the termination of the period, these annuities impose a heavier constant burden upon the taxes. In the case of perpetual bonds no provision is obligatorily made for amortisation, and consequently the fiscal officers have a better control over the expenditure for this purpose. At a time of great pressure on the revenues the perpetual bonds offer a better means of raising money than the terminable annuities, inasmuch as they will impose a

¹ This plan, now made familiar again by its adaptation to life-insurance business, is to make over in succession to the surviving members of a group of annuitants the shares of the members who die. The last survivor gets the whole amount, until his death closes the account.

smaller burden for the time being. But when the difficulty is over, it is not infrequently the practice to turn some portion of the debt into the form of terminable annuities, as that imposes upon future officials a fixed policy of debt payment. The investing public finds little or no absolute advantage in this form, for it is relatively hard to save up the principal again, coming as it does in dribblets, and the salable value of the security decreases continually, so that the command over the remaining portion of the principal is never good.

SEC. 6. Another favourite European form is that of lottery loans. A somewhat lower rate of interest on the loan is offered than would otherwise be accepted, and the balance of the *Lottery loans.* amount is divided among the holders of the securities on the lottery plan. Inasmuch as this is intended to appeal to the general love of gambling, the bonds are for small amounts, and are sold to the people. The plans for determining the disposition of the winnings of the lottery are varied. A combination of the annuity loan with the lottery loan is made when the State agrees to pay a certain proportion of the debt each year, the determination of which portion of the debt, or of which particular bonds, will be paid being made by drawings.

SEC. 7. In all of these forms of debt-making the chief problem of the practical financier is to fix the rate of interest as near as possible to the market rate. It is best that it should not be below the

market rate, for in that case the bonds will sell for less than par, and the government will have to pay back a larger sum than it receives. This addition is accumulated and compounded interest, which it is presumably easier to pay in annual instalments than at one time. The amount of the discount at which such bonds will sell depends, in part, on the length of time that they have to run.

When the market rate of interest falls, as it generally does in time of peace, below that at which the debt was contracted, it is generally desirable to reduce the rate of interest on the debt. If, therefore, the government can call in its bonds, it goes through the process of refunding; that is, it issues new bonds at the new rate of interest, and pays off the old ones with the proceeds. This advantage is peculiar to the perpetual bonds, and is consequently made use of whenever the rate of interest falls, which fact can be ascertained from the quotations of the bonds on the stock market.

SEC. 8. Perhaps next in importance to the great categories of debts we have been discussing are those included in the classification as *Debts of the treasury.* based upon specified revenues (II. A. 2). Of these, only those based upon the revenues of a definite period are common in national financiering. Most of the others, however, are common in local and municipal finances. Inasmuch as many taxes are payable only at certain times of the year, gener-

ally only once or twice, while the expenses run on through the whole year, there may be times when the treasury owes more than it has on hand. Some of these debts will be bills of account; others will be represented by notes of various kinds which the treasurer uses to pay bills with or discounts to obtain money. The latter, called "exchequer bills," "treasury notes," and the like, are generally willingly accepted, and often pass freely from hand to hand. They usually bear interest at the lowest market rate.¹ They are properly regarded as debts of the treasury rather than debts of the government, and are payable out of the next incoming revenues. These bills may swell to large amounts in times of sudden pressure on the finances, or they may be carelessly allowed to accumulate year by year, until they must be funded, or, perhaps, included in some general refunding or consolidation act.

In some cases, governments pay their debts or pay public salaries by "warrants" drawn upon the treasury at a time when the treasury is empty. The recipient of the warrant has one of two options: (1) he may wait until the treasury is refilled by the collection of the taxes; or (2) he may discount his warrant by selling it to some banker or broker, who presents it in due course. Not infrequently the "shaving of warrants," as this form of discounting is called, develops serious abuses. In any event,

¹ In 1894-1895 English exchequer bills for March bore interest at the rate of $1\frac{1}{2}$ and 1 per cent; June bills, $2\frac{3}{4}$ and $1\frac{1}{4}$ per cent.

throwing the cost of waiting upon the claimant is an abuse, and constitutes a tacit repudiation of the agreement with the claimant.

SEC. 9. Borrowing to secure the means for entering upon some productive enterprise is the chief cause of the debts of the several States comprising federal States and of local governments. Cities borrow to build waterworks, to construct street railroads, to establish a gas or lighting plant, etc. In the United States the different commonwealths have borrowed to aid in the construction of railroads or to establish banks. The enterprise in which the funds thus acquired are invested furnishes an additional security for the loan, and enhances the credit of the local body, because it is supposed that the enterprise itself will yield the interest and other debt charges. There are two ways of managing such enterprises. One is by selling the commodity or service produced; the other is by the assessment of a fee upon the users. So far as the debt is concerned there is little difference in these two methods. The former, however, introduces a speculative element, while the latter is more regular in its returns. Sometimes such enterprises fail, and the interest has to be paid out of the revenue from taxation. Not infrequently debts of this same kind are made to render assistance to private companies, and the expectation is that the companies will meet the interest charges. The bulk of local debts the world over are of this general character.

National governments, too, have sometimes contracted debts of this sort. Thus Prussia's debt was almost all incurred for the purchase of *National* "in-railroads, which pay the interest and *vested*" debts. provide for the sinking fund. Other countries of Europe have similar "invested" debts. The United States has given aid to railroads, but on terms that give no real surety that the debt charges will ever be met by the roads. The wisdom of such loans depends solely on the wisdom of entering upon such enterprises. It may even be wise under certain circumstances to advance money borrowed in this way to private companies which promise to provide some much-needed facilities, even without any hope that the interest and debt charges will be met in any other way than by taxation. That such debts when contracted should be treated in the same manner as any other debts, and paid as soon as possible, is a matter of good business management. The failure of the assisted private enterprise to make good the sums expended is no reason for the refusal of the government to meet the obligations thus incurred, and refusal under such circumstances is as destructive of credit as would be the failure to meet any other obligation.

The nature of all the remaining forms of debt is clear from their names in the table. A good many of them are merely formal in character and are incurred in carrying out some of the regular processes of business or law. Such debts are never included

in the sum total of the burden of debt, because the sums out of which they are to be met are received when the debt is contracted and retained until the debt is due. They are never, except in the case of the grossest mismanagement, a burden on the revenues.

These different forms of debts are all in constant use, and the indebtedness of any nation will show *A system of public debts.* almost all of them. The experience of the most advanced nation shows that there is as much need of a systematic arrangement of the different forms of debts as there is of the different forms of taxes. The various kinds of stocks are adapted to the differing needs of the treasury and the tastes of the lenders. The former must be consulted, perforce; the latter, if it is desired to obtain the most favourable terms; hence the scope for the exercise of good judgment on the part of the fiscal officers in the choice of forms.

CHAPTER III

NEGOTIATION, PAYMENT OF INTEREST, CONVERSION, AND REDEMPTION OF DEBT

SECTION 1. There are practically two methods for the negotiation of a public loan. One is to prepare the bonds or other evidences of debt for sale, fixing all the conditions and offering them to all comers who will accept those conditions. The other is to determine the amount to be raised, and then to negotiate with bankers or capitalists or other persons in order to ascertain on what terms the sum can be raised. There are, of course, many variations of these plans, but these are the principal ones. In the first case the State loses in a measure the advantage of competition between the lenders. One of the best examples of this method is the so-called "popular subscription." For example, a State decides to issue a certain number of bonds at a fixed rate of interest, selling them to all comers at a stated price. Certain places are designated for the reception of subscriptions. If the terms offered are too low, *i.e.* offer too little advantage to the purchasers, it may be that only a part of the loan will be taken up. If they are too high, the State, of course, suffers a loss.

In this case everything depends on the ability of the fiscal officers to gauge the market. This task is comparatively easy if the State already has a large number of stocks outstanding, the market price of which will roughly indicate the possible rate of interest that will be accepted on a public loan. But the extent to which the new loan will probably depress the market will have to be considered.

If the second method be the one chosen, the State lets it be known that bids for a certain sum are desired. The bankers and capitalists, and sometimes the public at large, then compete for the privilege of taking either the whole issue or a part of it. The different bankers offer to provide the whole or a part of the money needed at a certain rate of interest, or if the face of the bonds and the rate of interest have been fixed, offer to buy the stocks at a certain rate, generally quoted as so much per hundred. The most favourable terms offered by reliable bidders are then accepted, and they deliver the money in mass or in instalments to the treasury, in such form as may have been agreed upon, receiving in return the securities, which they are then at liberty to dispose of as they see fit. If the market price rises, the gain goes to the capitalists; if it falls, they lose. Of course the sums needed often exceed the wealth of any one person or group of persons, and each purchaser has to depend on his ability to dispose of the securities to raise the money to meet his agreement.

In both of these cases various secondary considera-

tions as to the form of the loan, the length of time it has to run, etc., affect the result. Sometimes it has been deemed wise to combine the two methods. That is, to negotiate with the bankers for terms on a part of the debt, and then to offer another part on similar terms to popular subscription, or even to allow of more general competition as to the terms.

SEC. 2. The amount of the interest or the rate is the chief factor in the negotiation of a debt; but the place and times of payment and the kind of money in which payment will be made are minor considerations of considerable weight. So, also, is the size of the bonds.

Place of payment of interest, and minor considerations.

In the case of popular loans which are intended to be subscribed for by the mass of the people, the bonds must be for small amounts; in other cases the units may be larger. There is no uniformity in this matter. The larger the bonds can be made, the easier it is for the treasury to manage the debt. Of some importance, too, is the choice between bonds that are payable to the holder, or to certain persons by name, and those payable to persons registered on the books of the State. If the bonds are payable to the holder, there is no need of a record of the holders by the government. The government is also spared the trouble and expense of recording changes in ownership. But there is an advantage of greater safety to the holders in the case of the recorded bonds, which are thus insured against loss or theft.

It is in general customary to determine the place

at which the interest, etc., will be paid. This is frequently some important commercial centre, sometimes the treasury of the State. If in the country issuing the bonds there be in circulation a debased, redundant, or depreciating currency, it is often agreed to pay the interest in some foreign commercial centre, or in foreign money, in order to secure payment in a stable currency. Thus many of the commonwealths of the United States which contracted debts between 1830 and 1850 agreed to pay the interest in London in order to insure the payment in gold, and to guard their creditors against loss from the depreciated currency then in circulation. When the States appealed to Congress for assistance in the payment of their debts in 1842,¹ this was alleged as a feature involving special hardship. A large part of Russia's debt is payable in Holland and England, and in all of it the kind of money is specified. The same is true of the debts of many other countries.

SEC. 3. While it is often necessary, in order to obtain the required funds on the best terms, to offer many different forms of public securities, yet in a time of absence of pressure it may become desirable to simplify these forms and to consolidate the debt. This involves the calling in of the outstanding paper and its conversion into

¹ See Johnson, *Report on the Relief of the States*, 27th Con., 3d Sess., House, No. 296; a perfect mine of information on the history of public debts in the United States up to 1842.

another form. Conversion is generally undertaken when a fall in the rate of interest offers the State an opportunity to gain by the process. The reduction of the rate of interest is possible whenever the State enjoys the privilege of repayment. It can then offer the creditor the choice of payment (for which it could obtain the money by the sale of new bonds at the new rate of interest) or of new securities at the lower rate. This mode of conversion or reduction of interest is, of course, perfectly legitimate. The reduction of the rate arbitrarily without the consent of the creditors is as much repudiation as the refusal to pay altogether. It is by numerous conversions and consolidations that the rate of interest on the bulk of the debt of Great Britain has been reduced as low as $2\frac{1}{2}$ per cent.

SEC. 4. The best justification of debt-making is that it distributes the burden of some heavy expenses upon a later period. The cost of this postponement is the payment of the annual interest. In order to fulfil the intention of the loan and to *Debts must* get rid of the cost of the process, it is *be paid.* necessary to pay the debt. If these two reasons were not sufficient, the danger of the recurrence of similar extraordinary needs and new appeals to credit, and the eventual danger of bankruptcy, point in the same direction. As we have already seen, some of the forms of debts contain within themselves the provision for payment. Life and terminable annuities involve the payment of the principal in annual instal-

ments. Other forms call for payment in larger instalments or at a definite termin, for which provision must be made by the collection of funds beforehand. If, however, the expiration of the period finds the debtor State not in the possession of the funds needed, it may have to borrow again to fulfil its agreements. In the case of most perpetual debts it would be obviously unfair to call upon certain holders for the surrender of their bonds and to allow other holders of the same sort of bonds to retain theirs, especially if the rate of redemption is below the market rate. The whole of any issue of bonds, therefore, must be treated as a unit. This involves the gradual accumulation of a fund for the payment of all of the debt of the same kind and issue. There is, however, another alternative. The government may enter the market with this fund, before it is large enough to pay all the debt, and purchase such of its securities as are offered for sale. Care must be exercised in the application of this method not to raise the price of the securities. In some cases arrangements are made in advance for calling a portion of the outstanding bonds by lot. This depreciates the whole issue, because each bond is liable to be called.

Provision made for the accumulation of a fund for the redemption of the debt is called *The sinking fund.* the sinking fund.¹ The sinking fund may be defined in two ways; either it is an annual fund,

¹ See Ross, "Sinking Funds," *Pub. Amer. Economic Assoc.*, Vol. VII., p. 445.

i.e. a portion of the annual income, or it is the accumulated capital from this and other sources applicable to the payment of the debt. Not strictly the earliest, but the first important, attempt at the arrangement of a regular sinking fund is that of England in 1786 under Pitt. This was a remarkable scheme. It is said to have been suggested by Price, a clergyman, who in 1772 wrote *An Appeal to the Public on the Subject of the National Debt*. His argument was based on the productiveness of compound interest. He urged that a fixed sum, however small, should be set aside every year for the purchase of public stock, and that the interest on the stock thus purchased should continue and should be applied to further purchases. There would then be two sources from which the debt would be cancelled: one, the payment of the annual amount; the other, the ever increasing interest fund. The effect of such a scheme in eventually discharging any debt was regarded as almost magical.¹ It was not perceived that the real efficacy of the scheme lay in the fact that the nation continued to bear the whole burden of the initial interest charge until the debt was paid, and that the real source of payment was the excess of taxation over expenditure. In accord with this idea Pitt *Pitt's sinking fund.* appointed a "Board of Commissioners of the Sink-

¹ As an illustration, compute the sum which a penny placed at interest in the time of Christ would amount to at compound interest.

ing Fund," who were to receive a fixed sum each year, with which to purchase public stocks, at or below par. Interest on the stocks thus purchased was to be paid to the commissioners, and quarterly applied to new purchases. This much-admired scheme amounted to adding £1,000,000 annually to the taxes needed for other purposes, and continuing the entire burden of taxation until the debt was paid. It is clear that what was really used for debt payment was the surplus revenue. The £1,000,000 was clearly that, and the interest on the stocks purchased therewith need not have been paid but for the sinking fund. There is, indeed, no source from which the debt can be paid but taxation or similar net revenue. So great was the faith of the government in this scheme that it continued the payments to the sinking fund even while borrowing for the war of 1793 and after. The fallacy of Dr. Price's arguments was pointed out by Professor Robert Hamilton of Aberdeen in 1813. Shortly after that, it was estimated that, as a result of the sinking fund system kept up during a period of borrowing, the government had, between 1785 to 1829, borrowed £330,000,000 at 5 per cent to pay a debt of the same size at $4\frac{1}{2}$ per cent. The scheme was then abandoned, never to be resumed. From this time on only genuine surpluses were applied to the payment of the debt. This abandonment of the idea of Price and Pitt, however, had a rather disastrous result, in that it largely suspended debt

payment in favour of tax remission. Since 1875 England has tried a new plan. Without committing herself to a policy which would involve paying debts with one hand and borrowing with the other, and without relying upon mere chance *The new sinking fund.* she decided to appropriate a fixed sum from the consolidated fund for the national debt services, to be continued as long as there were no extraordinary calls upon the funds. In 1895 £25,000,000 was the fixed charge for the national debt services, of which £1,718,263 3s. 7d. went into the new sinking fund ; whereas in 1875 the sum was fixed at £28,000,000, and a larger amount went into the sinking fund. During the Boer War and for a time thereafter the sinking fund was suspended. Thus in 1901-1902 the "national debt services" stood as follows: the "fixed charge" was £23,000,000, less £4,640,000, "sinking fund suspended," leaving £18,360,000, denominated as "inside the fixed charge" ; in addition to this there was £3,250,000 interest on the war debt, which was "outside the fixed charge." In addition to this England has been converting her debt into terminable annuities, resulting in a mechanical method of debt payment which may in time of pressure work as the old sinking fund did.

SEC. 5. The American system of debt-paying began in 1790 with the application of a surplus from tonnage fees and imports to the purchase of public bonds in order partly to improve the market price

of the bonds and by thus improving the country's credit to facilitate conversion. In 1792 the bonds thus purchased were made the basis of a sinking fund, it being determined that the interest on them should continue and be paid to a commission for the further purchase of public bonds. In 1795 the sinking fund commissioners were made the recipients of certain revenues to be applied to the payment of definite portions of the debt. Ross thus summarises this fund: "The sinking fund was now enlarged by the following additional appropriations: (1) so much of the permanent duties as, with existing income, should enable the commissioners to pay, in 1796 and thereafter, a yearly 2 per cent of the 6 per cent stock; (2) the surplus dividends on the government's \$2,000,000 of United States Bank stock after deducting the interest accruing on the remnant of the bank loan; (3) so much of the permanent duties as, with the surplus dividends, should suffice to pay a yearly \$200,000 on the bank loan, till 1802, and then begin the redemption of the deferred stock; (4) the proceeds of the sale of public lands; (5) the proceeds of debts inherited from the old government; (6) all revenue surpluses of any year remaining unappropriated during the next session of Congress."¹ This fund was not very efficient on account of the excess of expenditures. It served one very important purpose, however, that of regulating the credit of the United

American systems of debt payment.

¹ *Sinking Funds*, p. 49.

States by showing the intention to pay. In 1802 Gallatin organised another plan, which was continued for some time. It was to increase the revenues beyond the current expenditures and apply the surpluses to the debt payment. The results of the two plans have been compared as follows: "The inherited debt and accrued interest amounted in 1791, when funded, to \$76,781,953.14. The Federalists in ten years reduced this to \$72,733,599, but added \$7,193,400 of new stock, mostly at 8 per cent, thus bequeathing a burden of \$79,926,999 to their successors. Of this, Gallatin's sinking fund extinguished \$46,022,810 between 1801 and 1811. The purchase of Louisiana, however, added \$11,250,000 to the principal, so that on January 1, 1812, the public debt was \$45,154,189, over thirty-one millions less than the original Revolutionary debt."¹ This comparison is not altogether fair to Hamilton, the author of the older plan, for his fund enabled important conversions to be successfully made which reduced the debt charges. During the War of 1812 the payments to the sinking fund were suspended. After the war the debt stood:

Old debt remaining	\$39,905,183.66
Funded war debt	49,780,322.13
Treasury notes	18,452,800.00
Temporary loans	550,900.00
Total burden on the sinking fund	<u>\$108,689,205.79</u>

¹ Ross, p. 67.

The sinking fund was at that time composed of

Interest on stock held by com.	.	.	\$1,969,577.64
Receipts from public lands	.	.	800,000.00
From duties	.	.	5,230,422.36
Sinking fund	.	.	<u>\$8,000,000.00</u> ¹

The policy of protection, inaugurated after the War of 1812, separated income from expenditure. The ultimate purpose of most of the taxation, namely protection, was considered so paramount that a high rate of taxation was continued for that reason. The available surpluses were, therefore, large, and were from time to time applied to the debt. Down to 1824, when all the debt contracted up to that time was practically paid, the sinking fund was managed by a special commission, but since then the Secretary of the Treasury has had charge of it. The Civil War debt was by the act of February 25, 1862, supposedly placed on a secure basis. "The coin paid for duties on imports was to be applied first to the payment of interest on the bonds and notes of the United States. It was then to be applied 'to the purchase or payment of 1 per cent of the entire debt . . . to be made within each fiscal year, which is to be set apart as a sinking fund, and the interest of which shall in like manner be applied.' . . . The residue of customs receipts was to be paid into the treasury."² While no such regularity as was contemplated by

¹ Ross, p. 69, from *Finance*, Vol. II, p. 916.

² Ross, p. 79.

this act was realised, yet the debt has been paid from surpluses more rapidly than was anticipated, until the reduction of the revenues in 1895, due to a change in the policy in regard to the protective duties, together with a redundancy in the monetary circulation, which resulted in a foreign drain upon the gold reserves held for the redemption of notes outstanding, made new borrowing necessary. The war with Spain involved a new increase of indebtedness, which, however, was contracted on terms remarkably favourable to the government. The same general policy of debt reduction has continued, and the debt, which amounted to \$1,108,000,000 in 1900, was by 1908 reduced to \$938,000,000.

The commonwealth constitutions of the United States very generally impose upon the legislatures the duty of providing a sinking fund. Many of them, besides limiting the amount of debt that may be created, either by *Commonwealth sinking funds.* naming a fixed sum or a fixed proportion of the revenues that may be used for interest payment, also provide that whenever a debt shall be contracted, a tax shall at the same time be levied sufficiently large to pay the interest charge and provide a sinking fund. The general distrust of the legislatures is emphasised in the constitutions by making such laws irrevocable until the debt is paid. The commonwealths are thus permanently committed to the policy of debt payment, not so much on account of any deep-seated belief in the

efficacy of the particular methods laid down, which may necessitate the continuance of debt payment even at a time of borrowing, but on account of the widespread distrust of the prudence of the legislatures. The same distrust has destroyed the danger of the system, by almost entirely forbidding debt-making by the commonwealths.¹

SEC. 6. In conclusion, it would seem that the experience of great nations shows: that debts must be paid; that they can be paid only by increased taxation; and that the possible weight of taxation for this purpose is determined by a consideration (1) of the length of time it is thought desirable that the debt shall run, (2) of the existing burden of taxation, (3) of the general conditions of the people. When the debt has been contracted for some productive purpose, it seems fitting that the surplus earnings of such an enterprise should go to debt payment, as this eventually enables a permanent lowering of the cost of such services to the people.

¹ For a full account of the debt policy of the American commonwealths see my monograph, *Das Kreditwesen der Staaten und Städte der Nordamerikanischen Union in seiner historischen Entwicklung*, Jena, 1891.

PART IV

FINANCIAL ADMINISTRATION



CHAPTER I

THE BUDGET; ADMINISTRATION OF EXPENDITURE; CONTROL AND AUDIT

SECTION 1. To the fourth and last part of our subject belong the formal arrangements of the public finances, — the preparation and ratification of the budget, the care and preservation of the public funds, the administration and control of expenditures, and the collection of the revenues. It was this side of the subject that first attracted attention and which occupied a large part of the writings of the cameralists. Lorenz von Stein gives a very considerable portion of his monumental work to these subjects, and the able French writer, Stourm, has devoted to financial legislation a volume entitled *Le Budget*. English and American economists have generally left this field to the jurists and publicists, but Bastable devotes the last three chapters of his book to some of these topics.

In every well-regulated household and every

business concern the keeping of accurate accounts, the distribution of the funds among different persons, and the control of expenses have an importance second only to the broader questions of policy.

The importance of correct methods of fiscal administration.

Equally important in the greater housekeeping of the State are the formal arrangements for the enactment of fiscal laws, for the keeping of accounts, and for insuring compliance with the laws.

The general frame of the fiscal administration, the relation between the various departments, the assignment of particular powers and duties to the different officials or bodies, depends entirely upon the general political organisation. How these features differ from country to country it is the province of political science to describe. But the frame of administration has an effect on the finances; and there are certain principles demanded by sound finance which are followed by every country, no matter what its frame of government.

SEC. 2. Of necessity the methods of accounting and control do not assume a public character until there is a pretty clearly recognised popular interest in the affairs of the State.

History of fiscal administration.

At one time the Roman treasury under the control of the *Censors* and in charge of the *Quæstor's* exhibited the features of public economy. But under the Empire the public treasury and the private treasury of the Cæsars gradually merged into a single one, and the methods of accounting

became that of private rather than of civic house-keeping.

The middle ages were essentially unpolitical, and in that period no system of public treasuries proper was developed, except in the free cities. As we have already seen, there were no revenues collected in the monarchies for a distinctly public purpose until the fifteenth and sixteenth centuries, and consequently there could be no public accounts or public control over the funds.

The constant struggle between the representatives of the people and the officers of the older absolute governments for the control of the purse led to the development of distinct methods of accounting and control. *Conflict develops legislative control.* The most striking feature of the modern systems in European countries is the establishment of the budget, and of the right of the popular representatives to vote taxes and appropriations. In America the right of the legislatures to control the finances was clearly established at a very early date, and little or no advance has been made beyond the crude methods first developed. Most European countries have advanced more rapidly and perfected far better systems. This higher development of the budget in European constitutional governments is explained by the constant conflict between the branches of the government having interests which are theoretically opposed. The modern budget is an outgrowth of the gradual assumption of power by the legislatures,

and the corresponding loss of power by the executives. The latter have had to ask for funds, and the former in granting them have insisted upon knowing what they are to be used for, and upon having assurance that they will not be applied in any other way. In the United States, however, both the federal and the commonwealth legislatures suggest, or initiate, financial legislation as well as grant funds. Both of these functions of initiation and of grant being in the same hands, there is no conflict of interests such as has developed the systems of financial statements and legislative control in Europe. The only care in this country is to see that the funds are not appropriated to private purposes, while in Europe there is the desire to prevent the application of the funds to other public purposes than the ones specified.

SEC. 3. It has been claimed that the English system served as a model for the other European countries. However that may be, and it is true only in part, the English system will serve as a good illustration of the European methods. The fiscal year begins April 1 and ends March 31. Each department of the administration prepares a careful statement, known as the "estimates," for the coming year. These "estimates," each of which comprises a good-sized quarto volume, are tediously exact and minute in the statement of what it is expected will be needed for the forthcoming year. They are called the

*Europe in
advance of
America.*

*Making up
the English
budget.*

"army estimates," the "navy estimates," the "civil service estimates," etc. The Chancellor of the Exchequer, in turn, bases his estimate of all that will be needed upon these statements, and calculates the receipts from each source on the basis of the revenues of the previous year. He then presents all the documents to Parliament with a brief, clear statement of what the expenditure will be, what it is expected the revenues will be, what new taxes, if any, are needed, or what taxes may be remitted or changed, in order to make the revenues equal the expenditure. This statement is called the budget. "Usually, but by no means always, the proposals of the Chancellor of the Exchequer are accepted by the Commons, and even when they are not in detail, it is seldom that the items of expenditure are objected to. The House is supposed to go through the 'estimates' in detail; it forms itself into a 'committee of supply,' and sanctions every item in the three bulky volumes, but its members have not, as a rule, knowledge enough of the details to offer effective criticism, and the utmost the committee can be said to do, on the average, is to render flagrant abuses impossible. On the average, perhaps that is enough."¹ Parliament cannot directly or indirectly increase the appropriations asked by the ministry in the name of the Crown, nor add new appropriations. The estimates both of revenues and expenditure are

¹ Wilson, *The National Budget*, p. 147.

made with such great care that there is seldom either a surplus or a deficit of any large amount at the end of the year. According to Bastable the estimates of expenditure in England for the three years April 1, 1889, to March 31, 1892, as compared with the results, show an error of only £137,000 in a total of £264,000,000, or a little over 1s. per £100, or \$1 in \$2000. All credits of disbursing officers expire, and their accounts close, March 31. All appropriations lapse at that time, except those appropriated for the consolidated fund. It requires a special act of Parliament to spend any more money on last year's account, even though the original appropriation may not have been exhausted.

In the United States there is no connection between the executive and legislative departments of the government that would allow of any such arrangement as that of the budget in England. The reports of the administrative officers, the President, and the Secretary of the Treasury, are made to Congress and are often accompanied by suggestions of various sorts. But the executive officers have no real access to the ear of the House. Therefore, no formal budget is presented to Congress. Two separate committees in the House (where finance bills originate, although they may be amended by the Senate) deal regularly with finances; one with taxation, the other with appropriations. These committees are the "Committee on Ways and

Means" and the "Committee on Appropriations." Bills involving expenditure or taxation are regularly referred to these committees. The control of these committees rests solely on convention, there being no constitutional provision for such reference. Even after the committee has presented an appropriation or revenue bill, there is the greatest freedom of amendment, and theoretically any member of the House could, if so inclined, present an entire new set of such bills forming a budget. Appropriations may be increased or decreased, or new ones introduced, without reference to the committees. Practically the control of these committees is very great, especially in the matter of suppressing appropriation bills that may be referred to them for consideration. Certain lines of expenditure may be suggested by other committees, and theoretically may be voted on without reference to these controlling committees. For example, the navy and war departments may receive appropriations suggested by the committees in charge of them. Many other committees, as, for example, the ones on claims, on invalid pensions, pensions, etc., regularly bring in bills involving expenditure.

Ever since the protective policy was fully established the United States government has been in the possession of large revenues, which are not determined in any way by the expenditures. So that the consideration of revenue bills has always been complicated by other

*Revenue laws
sundered
from appro-
priations.*

than fiscal considerations, except during the Civil War. This sundering of the functions of spending and of obtaining revenues, and the general scattering of appropriations, would apparently cause the utmost confusion. But the result is not so bad as might be expected, (1) because of the influence of the committees, (2) because, of course, some attempt is made by the House itself to ascertain whether funds are or will be available for the purposes suggested, (3) because the tax system has not been a variable one, and has yielded a fairly regular and gradually increasing revenue, to spend which has sometimes taxed to the utmost the ingenuity of Congress. But the system absolutely prevents any systematic oversight of the finances as a whole, and allows of no measurement of the relative weight of each appropriation. Credits to spending officers do not expire at the end of the fiscal year, July 1, as in England, but generally continue in force until the entire sum is consumed or the object is accomplished. Congress thus loses one advantage for the control of expenditure that Parliament enjoys. The American system, however, has one great advantage over the English in that it allows of a more critical investigation by the legislature of the specific items of each appropriation.

The date at which the fiscal year expires is generally set with reference to the convenience of officials in rendering their reports and to the meetings of the legislatures. The ac-

*The fiscal
year.*

counts presented are generally for gross income and expenditure, so that the details of the cost of collecting revenues and chance savings of expenditures can be controlled.

There is theoretically no sanction for expenditure of any kind beyond the amount appropriated by the legislature. If any expenditure not so sanctioned is of pressing necessity, the *Deficiency bills.* administrative officers may sometimes assume the responsibility and make the appropriation, subject to the ratification of the legislature when it next meets. This discretionary power is exercised to a very limited extent in most countries. In the United States, however, the disorder attendant upon the appropriations involves the annual presentation of a "deficiency bill." When any action involving expenditure has been sanctioned by the legislature, and insufficient funds have been appropriated, there is a moral obligation resting on the legislature to make the requisite appropriation afterward.

SEC. 4. When the budget has been prepared and voted, the next step is to see that the expenditure is carried out as authorised and to prevent any misappropriation of the funds. In *English control and audit.* England the funds are deposited with the Bank of England, subject to the order of the comptroller and auditor-general only. This officer's duties are a combination of those of the old board of audit created by Pitt in 1785 with those of the Exchequer, and date from 1866. No payment is made without (1)

an act of Parliament, (2) a requisition by the treasury¹ issued to the comptroller-general, (3) a grant of credit for the amount authorised by the act good for one year, (4) a treasury order directing the transfer of the money to the paymaster-general of the service.² As the estimates have been closely scrutinised, there is little opportunity for the misapplication of funds. There is none whatever for overdraft. Again, after the expenditure has been made, the accounts with vouchers are passed through the comptroller's office for his approval, or audit. The report of that officer is subjected to the final revision of the parliamentary committee of public accounts. Thus the whole process begins and ends with Parliament. It will be seen that there are really two parts to the process. First, the control over the "issues" to the disbursing officers, that is, over the placing of the public moneys in their hands. Secondly, the audit of the accounts after the expenditures have been made.

SEC. 5. In the United States³ the direct control of the money is in the hands of the executive officers, subject to the statutes of Congress. The safeguards consist in making the processes of expenditure complicated and subjecting each item to the scrutiny of several sets of executive officers.

¹ See Wilson, *The State*, pp. 696-698.

² Cf. Bastable, p. 705.

³ See Renick and Thompson, *Political Science Quarterly*, Vol. VI., pp. 248-281, and Vol. VII., pp. 468-482.

The idea of the original plan in the United States was not to allow of issues to the regular disbursing officers, but to control expenditure by a careful scrutiny of the accounts or claims rendered. The treasury was to be reached only after the claims had been cut down to the lowest possible figure. Claims against the government were first passed upon by an auditor, then by a comptroller, either of whom might reject them. Then the secretary drew a warrant upon the treasurer, and that warrant was recorded by the register and countersigned by the comptroller. Hamilton found it necessary, for the sake of economy, to pay cash for many things needed by the government, and hence this original plan broke down. Issues were made to disbursing officers, and the necessary warrants were drawn for each particular item of expenditure, afterward, in order to legalise the transaction.

For many years the United States had a very complicated system of audit, control, and record. There were six auditors, so called, and the "commissioner of the general land office," who was auditor for the lands account. Then there were three comptrollers, known as the first and second comptrollers, and the commissioner of the customs. Lastly there was the register. All of these were assisted by a large body of clerks. These offices were organised into four co-ordinate branches, with separate jurisdiction. Ac-

*Original plan
of control and
audit in the
United States.*

*The recently
abandoned
plan.*

counts were first examined and passed upon by an auditor, then reëxamined by a comptroller. Claims disallowed by these officers could be pushed in the Court of Claims and appealed from there to the Supreme Court. The assignment of accounts to the different auditors and comptrollers was almost arbitrary and with little system. The first auditor looked over the general income and expense accounts of the treasury, the special accounts of the customs receipts, the expenditures for the legislative and executive departments, special accounts of the treasury department,—as of the interstate commerce commission, of the public debt, of engraving and printing, of the coast and geodetic survey, of the life-saving service, of the lighthouse establishment, of the public buildings, of the government of territories, of the District of Columbia, of the central administrative departments of war, navy, the interior, etc., of the departments of labour and of agriculture, and all the expenditure for the judiciary. The second auditor had the accounts from the Indian service and the army. The third auditor had the pension account. The fourth had the accounts of the navy. The fifth looked over the accounts of the collector of the internal revenues. The sixth was for the postal accounts. The first comptroller then revised the accounts that were assigned to the first and fifth auditors, except the customs account, for which the commissioner of the customs was comptroller, and those of the commis-

sioner of the general land office. The second comptroller had the accounts of the second, third, and fourth auditors.

All of this was changed by "the act of July 31, 1894, making appropriations for the legislative, executive, and judicial expenses of the government for the fiscal year ending June 30, 1895. This act altered the accounting offices of the treasury and changed materially the system of accounting. The detail revision of accounts heretofore made by the first comptroller, as well as by the second comptroller and the commissioner of customs, was abolished, as were the offices of the second comptroller and the commissioner of customs, the first comptroller being made the sole comptroller of the treasury. A revision of accounts under the new system is only made when either the head of a department or the claimant is dissatisfied with the settlement of an account by an auditor, or when the comptroller himself has reason to believe that any particular account ought to be subjected to a second revision. Much labour has been saved by this system, and the adjustment of accounts has been greatly expedited. It was one of the duties of the first comptroller to 'countersign all warrants drawn by the Secretary of the Treasury which shall be warranted by law.' This duty was continued with the comptroller of the treasury under the new system. As the Secretary of the Treasury has the duty devolved upon him of originating warrants,

*The present
plan of audit
and control.*

and as all such warrants must be countersigned by the comptroller, no warrant finally becomes effective without their concurrent action."¹

There are now six auditors: (1) for the treasury department, (2) for the war, (3) for the interior, (4) for the navy, (5) for the State and other departments, (6) for the post-office. The accounts are still distributed in the old arbitrary unsystematic fashion among the different auditors according to the illogical scheme by which the different duties are divided among the departments.² It is hard to see how this can be bettered until the work of the departments is rearranged. The recent change is a great gain in the direction of simplicity and speed. The auditor's work stands unless appealed to the comptroller, and is no longer necessarily gone over again by a comptroller.

The register keeps ledger accounts with all appropriations made by Congress, and also keeps all *The Register's* the personal disbursement and receipt office. accounts pertaining to the customs, internal revenue, diplomatic, treasury, judiciary, interior, civil services, and the public debt. General receipt and expenditure ledgers have been kept running from the foundation of the government. The register furnishes to the proper accounting officers copies of all warrants covering proceeds of government property, where the same may be nec-

¹ *Finance Report*, 1894, pp. 836, 837.

² See Wilson, *The State*, pp. 567-570.

essary in the settlement of accounts in their respective offices. He also furnishes certificates of balances, advances, and repayments to the offices of the first and fifth auditors, for settlements of accounts, and certifies to the first comptroller, on requisitions for advances, the net indebtedness of disbursing agents as shown by the ledgers.¹ The treasury department itself exercises a pretty extensive supervision over expenditures.

The system of disbursing officers, one connected with each bureau, commission, department, or other branch of the government to which appropriations are granted, still continues in the federal government. Each of these officers, under bond, receives such advances from the treasury as may be necessary, and pays the various claims that may come up against his appropriation. He is responsible for the payments he makes until released by the approval of the proper auditor and of the comptroller.

In general it may be said that public audit is much the same as private audit. It has for its object a certification, by some properly constituted authority, that each collection and each disbursement was made in accordance with law. The fact that in public audit the connection between the collection or the disbursement and the *law* has to be clearly established gives to public audit a degree of formality that is not always observed in private audit. Another difference is found in the fact that the public audit usually

¹ *Finance Report*, 1894, p. 737.

closes with a formal certification, which relieves the collecting or disbursing officer of further responsibility. Such certificates are either issued to the officers, at stated intervals, or are appended to each voucher, whether for collections or for disbursements.

CHAPTER II

COLLECTION OF THE REVENUES, CUSTODY OF THE FUNDS, AND THE PUBLIC ACCOUNTS

SECTION 1. Under the early methods of collecting revenues, the tribute due, the economic receipts, and the voluntary contributions were delivered directly to the chief or leader. Many of the early direct taxes were similarly treated. Indirect taxes upon commodities and transactions could not be managed in this way. The first crude method of dealing with these taxes was that of the tax-farmer, *Early methods of collecting revenues.* He purchased, for a price, the privilege of collecting all of certain kinds of taxes that he could obtain. The same method was extended to other taxes where there was no similar necessity for it. This farming of taxes was used through the imperial era of ancient Rome, and copied by France, it was extended into modern times. The various direct contributions of the middle ages which were apportioned among the different cities or "estates," were frequently delivered directly to the prince or his treasurer. All of these crude methods were abandoned as soon as there was a distinct recognition of the authority of the taxing power over all the different parts of the country and

over each contributor individually. The apportionment system, as originally used, was a more or less distinct recognition of the autonomy, and possibly of the partial political independence, of the taxpayers, be they provinces, cities, or classes of individuals.

SEC. 2. The collection of the taxes is usually the duty of the regular fiscal officers of the general administration, but industrial and commercial receipts are frequently collected by special boards in charge of them, who turn the money over to the treasury. Assessment and collection are so closely connected that they can be studied together. In the collection of customs duties there are two things for the officials

*Collection of
customs
duties.*

to care for. (1) They must look out for the arrival of all the taxable commodities and prevent smuggling. (2) They must ascertain the value of the goods if the taxes are *ad valorem*, and the number and size of the pieces if specific. The invoices, supported by the usual certificates, oaths, etc., are of the nature of a declaration by the owner, or importer. They are then subjected to the scrutiny of official appraisers, whose knowledge of the nature and value of the goods is very accurate. The tax is then paid to the collector at the place of importation or when it reaches the recipient in the interior, but before it is delivered to him. In case the goods are to be admitted into the interior of the country, or of the customs district, before the tax is paid, as is the case when the person to whom the goods are sent resides in the interior, the pack-

age is sealed up, or "bonded," and the seals can only be broken by an authorised collector after the payment of the tax. In countries where there are no general tax-collectors in the interior, this method is not feasible, and the goods are held in the custom-house on the boundary until the tax is paid. With a few exceptions this is the practice of the United States. But in Germany, where there are regular fiscal officers of the central government in almost every hamlet, goods are regularly shipped to the consignee, and the tax paid in the interior.

In the case of excises, the factories, breweries, fields, and other places where the taxed goods are produced are subject to regular inspections, and are more or less under the constant supervision of the officials. The tax is collected directly from the producer or by the sale of stamps and licenses.

*Collection of
excises.*

SEC. 3. In the case of direct taxes, it is the assessment that is the most difficult part of the process. The methods of assessing some of the taxes have already been suggested. The work consists of two parts. (1) It is necessary to ascertain the base — the persons, the property, or the revenues subject to taxation. (2) It is then necessary to fix upon the valuation, or the rating of the base in each particular case. The latter part of the process is "making the assessment." In this the contributor may be called upon to assist, or the officers of the government may proceed entirely

*Assessment of
direct taxes.*

alone. Generally a declaration is requested, or may be required, from the taxpayer, and the officials then investigate the truth of that declaration. In Europe it is customary to form assessment commissions consisting of representatives of the taxpayers in the district, who are acquainted with the local conditions and act with the officers of the government. These commissions help the regular officers of the fiscus to make the assessment, or sit as a sort of court to hear appeals from the assessment made, or both. The final assessment, however, is made by the fiscal officers.

In the American commonwealths the assessment of the general property tax is usually made by a board of locally elected assessors or an assessor. The assessor calls for declarations from the different contributors. The law in most States imposes severe penalties for failure to comply with the requirement of declaration or for false declaration. But, nevertheless, there is, for the most part, the utmost laxity in enforcing the law concerning declarations. Only the unusually conscientious, who voluntarily come forward with complete statements, are reached in this way. So general is the habit of neglecting this duty that it is practically impossible for the assessor, no matter how anxious he may be to have the law complied with, to prosecute all the persons whom he knows are evading assessment. The general practice is to default the declaration and allow the assessor to find

*Assessment of
the general
property tax.*

out, if he can, what taxable property the contributor has. If this were done by only a few persons, they could easily be brought to terms under the existing laws, but

*Difficulty of
obtaining
"declarations."*

when nine-tenths of the population refuse to comply, the assessor is helpless, and the only effect that follows from the declaration by the few is to make the existing inequalities of the general property tax worse than ever. Real estate and other visible property is easily assessed. The officer has at his command the records of titles, of deeds, etc., which he can investigate, and he ascertains the value of each piece from his own personal observation of prevailing prices. As we have seen, personal, intangible property escapes almost entirely. It would seem that this difficulty of administration is insuperable. No merely severe methods of assessment will ever cure the evil.

Above the assessor in the United States there are generally two boards of equalisation, though sometimes only one. The first board is local, covering the same district as the assessor.

Equalisation.

This hears appeal from the taxpayers in regard to their assessment. It equalises between individuals. The second board is for the whole commonwealth, and is known as the state board of equalisation. This board is to adjust the burden of state taxation equally between the different districts. As has already been explained, a local assessor may make the assessment in his district lower than that in the other

districts. This will not affect the burden of local taxation, for all that is needed is to raise the rate. But it lessens, if the assessment stands, the burden which the state taxes impose. These central boards are of three kinds: (1) those with power to add to or subtract from the assessment of each district, but in such a way as not to change the total amount; (2) those with power to change the assessment of any district, and which may and generally do change the total assessment of the state; and (3) those with power to change the valuation not only of districts as a whole, *but* of classes of property, or even of individuals within any district. As these boards seldom have sufficient powers, and never sufficient information as to the local conditions, the effect of their action is not all that could be desired. The only possible solution of this difficulty is the separation of local taxation from that of the commonwealths, so that the assessment can be made independently for each.

SEC. 4. After the assessment has been completed, it is comparatively easy to make the collection. All that is needed is a collecting agent of the treasury conveniently located, to whom the taxpayers may go, or a collector who goes to the taxpayers. The burden of taxation may be seriously increased if the convenience of the taxpayers is not consulted in this matter. The size of the district over which a collector has supervision will depend upon the density

*Convenience
of the contrib-
utor to be con-
sulted in
collection.*

of the population. If the collector is to be sought out by the contributors, it is best that his office should be located in some business centre frequently visited by the contributors. According to the principle of "certainty and convenience," the taxes assessed upon the same person should all be entered in a single bill and all be payable to the same collector. The taxpayer should be informed as early as possible of the total amount of taxes that he has to pay, of the number of instalments in which they are payable, and of the conditions of delinquency and its penalty. Some of the American commonwealths disregard this rule entirely. They add grievously to the burden of taxation, especially in the country districts, where they are already entirely out of proportion to the ability of the people, and increase the irritation felt by the contributors, by inconvenient location of the collector's office, and by requiring the payment of state and county taxes to one set of collectors, while the town and other municipal taxes are paid to a different set and upon separate bills. The most economical and least irritating process is to have all the taxes collected by the same person.¹

SEC. 5. The transfer of the public funds from one part of the country to another is, in modern times, attended with little risk. It is most conveniently

¹ The writer knows of an instance where a farmer has to travel fifty miles to pay his state and county taxes, while the local taxes are collected within two miles of his home. This is not an extreme case.

done by means of the banks or the post-office. If the country is sparsely populated and insecure, the collector's office should be at or near the bank or vault in which the money is to be stored. In large countries, as, for example, the United States, it is convenient to have a number of branch treasuries scattered about the country, at which collections can be made, and through which money for expenditure can be distributed to the disbursing officers.¹

The storage or safe-keeping of the funds is accomplished in one of three ways. (1) As in England a great State bank is made custodian of the funds which are sent to it from the various collectors who deposit with its branches. (2) As in France and the United States the treasury and the subtreasuries are the chief custodians of the funds.² (3) As in the commonwealths of the United States, where, except in a few states, private or other banks are made the depositories of the public moneys. When protected by proper safeguards, such as the giving of personal bonds and collateral, the bank depository system has proved itself far safer and more economical than the independent treasury, which is only to be defended on political

¹ Subtreasuries are at Baltimore, Boston, Chicago, Cincinnati, New Orleans, New York, Philadelphia, St. Louis, and San Francisco.

² According to law, the treasurer and disbursing officers of the United States may make deposits in the national banks. About \$14,000,000 are regularly so deposited.

grounds, if at all. The experience of the United States federal government in the early days with "pet banks" points to the political difficulties of the bank depository system. The bank deposit system prevents the periodic disturbance of the circulation by the withdrawal or storage of money. If the independent treasury system were used by all the departments of the government, this disturbance would possibly be serious enough to affect prices.¹

SEC. 6. The mere mechanical details of the methods of bookkeeping and public accounts cannot be described here. About all that can be done is to make such explanation as will enable the student to easily comprehend the published accounts and statistics in their main features.

The revenue account is generally very simple. It contains items named according to the sources from which they come. Care must be taken in studying the reports of the fiscal officers on the revenues to distinguish the *Public accounts, English.* receipts that represent income from the receipts that are merely formal transfers and bookkeeping expedients. For example, the English finance account of the United Kingdom for the year ending March 31, 1895, contains the following : Receipts—I. Balance in Exchequer, April 1, 1894, £5,977,118 18s. 9d. ;

¹ Cf. Kinley's "Independent Treasury," and Buckley's "Custody of State Funds," *Annals of the American Academy*, Vol. VI., 3, November, 1895.

II. Revenues received into the Exchequer, viz. customs, excises, etc., £94,683,762 10s. 2d.; total, £100,660,881 8s. 11d. This was what England had to draw on. But following that appear a number of other "Exchequer receipts," among which are repayments of advances; as, (1) by the mint for the purchase of bullion for coinage, £700,000, representing merely a return to the Exchequer of money temporarily passed to the mint. The same year the Exchequer advanced to the mint £615,000, which will appear in 1896 as a receipt increased by the seigniorage. (2) The Exchequer borrows money temporarily in anticipation of the revenues. This appears, of course, as a receipt of £13,700,000, but is not revenue. (3) It renewed a number of outstanding bills and bonds amounting to £14,123,400. These appear as receipts, offset, of course, by an equal expenditure. But (4) it created an additional debt of £760,000, for barracks and telegraph. This sum may fairly be called revenue. So that the total amount of money that came as actual income to the treasury was £101,420,881 8s. 11d. But the total receipts foot up £130,217,647 13s. 8d.

On the expenditure side the issues or credits to disbursing officials, are first, the consolidated fund "services"; that is, the payments for (1) the "national debt services," (2) the "other consolidated fund services," which consist of the civil list, annuities and pensions, salaries and allowances, courts

of justice, miscellaneous "services," the Exchequer contributions to Ireland, and the annuity under the Indian army pension deficiency act of 1885. After the consolidated fund "services," which foot up to £26,500,000, come the supply "services" for the army, ordnance factories, navy, and miscellaneous civil "services," for the collection of customs and inland revenue, post-office, telegraph, and postal packet "services." These two items, the consolidated fund and supply "services," contain all that is strictly chargeable to the revenue. They amounted in 1895 to £93,918,420 18s. 4d. In addition there were special expenditures of £810,000, making a total of £94,728,420 18s. 4d. But there were a large number of additional issues: (1) bills and bonds paid off by receipts from new bills, (2) temporary advances repaid, a part of which were for deficiencies in the consolidated fund. These and one or two other minor items, with a balance of £6,300,826 15s. 4d., brought the "issues" up to the receipts.

In studying the accounts published by the treasury department of the United States, we have different difficulties to meet. There is generally a clear statement, free from repetitions, or transfers, of the revenues according to the sources, and of expenditures according to departments, or objects. The only difficulties arise from the peculiar and arbitrary grouping of the expenditures. This comes from the

*Public
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illogical distribution of duties among the different departments already referred to. Some of the peculiarities are that the expenditure for the "civil establishment" includes foreign intercourse, public buildings, collecting the revenues, deficiency in postal revenues, rebate of tax on tobacco, refunding of direct taxes, French spoliation claims, District of Columbia, and similarly incongruous items. Those for the military establishment included rivers and harbours, forts, arsenals, and sea-coast defences; for the naval establishment included construction of new vessels, machinery, armament, equipment, and improvement of navy yards. Expenses not otherwise classified are generally listed as expenses of the treasury department.

SEC. 7. An interesting phase of public bookkeeping is the separation of accounts into funds.¹ When *The "funds."* Parliament voted a tax, it was formerly for a definite purpose, and the plan was to reserve the whole of it for the proposed purpose. But the receipts and expenditures of these funds never exactly balanced, and simplicity finally required that all should be turned into the consolidated fund. This method of bookkeeping is best exhibited to-day by the accounts of the commonwealths in the United States, although also used in national and municipal accounts to some extent. All the receipts are distributed among various so-called "funds,"

¹ A "fund" in this sense is practically an appropriation for a specified purpose or group of purposes.

or accounts, according to some prearranged plan. A separate account is kept of all receipts and expenditures belonging to each fund. With the exception of a few trust funds arranged to keep certain sums inviolate, these funds are, in effect, mere book-keeping contrivances. With the exception of the general fund, which receives all the money not otherwise appropriated to special funds, each of these accounts generally bears the name of the expenditure met thereby, sometimes of the revenues supplying them. In some commonwealths the number of these funds is very large.¹ The accounts are sometimes complicated by transfers from one fund to another, in which case they appear twice in the account, and frequently swell the apparent receipts enormously.

Local budgets are necessarily determined by the frame of local government and the number of functions performed by each. Thus in Eng- *Local*
land the public function to be performed *accounts.*
constitutes the basis of local organisation, and until the recent reforms each local governing body had only one or two duties; hence only one or two general accounts of expenditures, and one or two sources of income. But in America each local governing body generally has charge of all the local functions affecting a certain area, and may have as many expenditures and revenues as a com-

¹ See Seligman, "Finance Statistics of the American Commonwealths," *Pub. Amer. Statistical Assoc.*, December, 1889.

monwealth, or even more. Here methods of accounting defy classification and frequently defy sensible interpretation, even by the officials in charge. There is a crying need for reform here in the direction of uniformity.¹

¹See in this connection a form suggested for published reports of municipalities by Professor H. B. Gardner, in the *Pub. of the Amer. Statistical Assoc.*, June, 1889, and adopted, in part, by the Eleventh Census of the United States, as the basis of schedules and inquiries sent to the municipalities. The studies of local and commonwealth accounting made by the United States Census Bureau and published in the volume on Wealth, Debt, and Taxation, 1907, are especially valuable.

CHAPTER III

FINANCIAL ADMINISTRATION OF WAR; ILLUSTRATED BY THE EXPERIENCE OF THE UNITED STATES IN THE WAR WITH SPAIN

SECTION 1. A serious war usually imposes a sudden, new burden upon the treasury, the exact, or even the approximate, size of which it is not possible to estimate at the outset. Many of the expenses of war belong to that class *"Extra-ordinary"* which financiers call "extra-ordinary" to *expenses.* distinguish them from the usual or current expenses of the government. The amount by which the ordinary expenses are increased in time of war depends upon many circumstances. Obviously, the chief factor is the size of the forces engaged and the duration of the struggle. Naturally, the chastisement of a few dozen hostile Indian braves in the immediate vicinity of the regular army posts involves practically no "extra-ordinary" expenses. Allowance is usually made in the ordinary budget for the expenses a war of that kind would occasion. But many circumstances less obvious than the size of the forces engaged enter into the determination of the amount of the "extra-ordinary" expenditures. Thus, for example, a naval war, unless it happens to become the occasion for the purchase of new ships,

involves comparatively little addition to the ordinary expenses of maintaining the navy. A country which has a large standing army incurs relatively less "extra-ordinary" expense when engaging in war than a country which, like the United States, has only a small regular army.

The ordinary expenses being provided for by the regular budget, the financier's chief concern in time of war is the provision of the "extra-ordinary" funds. If the operations of the war are likely to interfere with the ordinary revenues, he must furthermore be prepared to treat a part of the ordinary expenses as "extra-ordinary," at least to the extent of furnishing new means to meet them. It is not often possible, and still less often expedient, to curtail the ordinary expenditures in any way for the purpose of saving

The problem presented by war. money to meet the new expenses. How to increase the receipts of the treasury by an amount sufficient to insure the efficient conduct of the war, without too serious disturbance of the industries and commerce of the people, upon which all the revenues depend, is the problem for the finance minister to solve. The "extra-ordinary" demands come thick and fast, especially at the beginning of the war, and they must be met, and met at once. The amount which may be needed at any given time is not ascertainable. But in spite of that, sufficient funds must always be on hand. Upon this more than upon any other one thing depends the fate of war. The war financier can

never plead that he has no funds, nor can he ask for time in which to collect. He must have the money when it is wanted and in the amounts required. No degree of skill on the part of officers or bravery on the part of the men, no degree of self-sacrifice at the front, can compensate for failure on the part of the financier to provide the ways and means. His powers are, therefore, of the greatest and most unusual.

SEC. 2. Possibly the most natural source to turn to in time of war for the increased revenues needed is the existing system of taxes. At first *Increased rates for old taxes.* thought it might seem proper to attempt to obtain new income by raising the rates of the old taxes. To some extent this is possible. In every well-arranged tax system there should be some taxes which can be made to yield an increased revenue by simply raising the rates. One of the chief reasons for the establishment and the retention of the British "property and income tax," for example, is found in the elasticity of the returns. But not all taxes can be treated in this way. Sometimes an increase in the rate of taxation will disturb industry and commerce and do a greater injury to the welfare of the people than is received from the damages of war. Again, an increase in the rates of certain taxes will diminish the revenue or even destroy it entirely. In not a few taxes the only way to increase the revenue is to lower the rates. This is the case with most protective duties. Any change

in the rate of such taxes is bound to affect industry and commerce, and to affect them unfavourably in the first instance, whatever the subsequent effect may be. A war brings perplexities enough to business without the creation of artificial ones, and the financier should not interfere with these taxes. It added not a little to the perplexities and dangers of the Civil War in the United States that the industry and commerce of the people were repeatedly disturbed during the war by changes in the tariff as well as by the military and naval operations themselves. There are, therefore, but a limited number of old taxes from which any aid can be sought. In the United States, owing to the one-sided system of federal taxation, the number of them is very small indeed. The American financier must look elsewhere for his new revenues.

SEC. 3. The next resource, naturally, is new taxes. But the establishment of new taxes, or even the restoration of old taxes not in use at the time of the war, is a matter requiring considerable time. Even if it were an easy matter to decide upon the best form of taxation and to get the necessary authority from the legislative branch of the government, the organisation of the new administrative forces for the collection of the taxes is a matter requiring time. No new system of taxation reaches its normal revenue-yielding powers within many months of its enactment. If the taxes are entirely new, the time required is longer.

But even if they are more or less familiar to the people from use on some previous occasion, a considerable lapse of time must intervene between the beginning of war and the receipt of sufficient new revenues to meet any considerable part of its expenses. Furthermore, the expenses of war are now so enormous that any system of taxation which raised, or attempted to raise, the entire amount needed during the probable duration of the war would be so burdensome as to crush the people. It is therefore extremely unwise, and practically impossible, to attempt to raise the entire cost of the war by immediate taxation. The only other resource is borrowing.

SEC. 4. The use of the public credit in time of war is attended by many special difficulties. The outcome of war is always more or less uncertain. Even if defeat would not entirely cripple the nation's resources and render the repayment of the loan uncertain, or affect the payment of interest, yet there are many considerations which make the lender hesitate. The fact that the duration of the war, the extent to which other nations may become involved, and many similar considerations affecting the size of the total demand upon the public credit are unknown, vastly increases the difficulty of placing a loan on favourable terms. But on that very account it is particularly necessary for the successful administration of the war that everything should be done to

*The use of
credit in
time of war.*

strengthen and preserve the nation's credit. There may come a time in the progress of the war when the only source from which any funds can be had is the money market. If, therefore, the financier has done anything to weaken the nation's credit at the beginning of the war, he is apt to be helpless at the close. Credit tends to weaken as debt increases.

It is for this reason that resort is frequently had in early war-borrowings to the simplest and most primitive method of debt-making; namely that which provides revenues for the payment of the interest and the repayment of the principal at the very time the debt

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is contracted. The creditor sees in the new funds flowing into the treasury the security for his advances and the guarantee of good faith on the part of the government. So long as every new loan is accompanied by new taxes from which its cost can be met, the public credit is practically secure. But if, on the other hand, the government neglect this precaution during the first stages of the war, any attempt to resort to it at a later stage is apt to be regarded as the desperate device of unsound financial management and the presage of coming bankruptcy.

Public credit is a plant of slow growth and extremely tender. It withers in a day before a breath of doubt.

Inasmuch as a successful outcome cannot be hoped for in modern warfare without the funds obtainable solely by public borrowing, and the necessity for

loans increases the longer the war continues, it behooves the modern war financier to guard the nation's credit as his most precious treasure. No sacrifice is too great which will strengthen it and preserve it intact for the later stages of the war.

SEC. 5. Such, stated in condensed form, are the general principles which should guide the fiscus in time of war. No better illustration of the application of these principles can be found in history than is afforded by the operation of the United States treasury during the war with Spain; and by following in some details the story of that war, we can obtain a clearer view of the principles themselves.

The situation, as it confronted Secretary Gage when the news of the destruction of the *Maine* reached Washington, may be summarised somewhat as follows. The treasury had a balance on hand of about \$225,000,000. But, as we shall see below, only about \$25,000,000 of this was really available for immediate use in the prosecution of the war. The ordinary expenditures of the government, outside of those for the postal system, which was nearly self-supporting, amounted in round numbers to \$350,000,000 per annum. For the first time in many months these expenses were being nearly met by the revenues. Indeed, it was estimated that at the ordinary rate of expenditures there might be a slight surplus at the end of the year. The tariff was expected to yield about \$200,000,000, the inter-

The situation of the United States treasury at the outbreak of the war.

nal revenue taxes about \$165,000,000, and there were about \$25,000,000 to be expected from miscellaneous sources.

SEC. 6. The larger part of the income, however, came from taxes which could not well be tampered with. The tariff had been so long a subject of controversy that there was little desire to alter its recent settlement. For reasons already made clear, there were many parts of the tariff which could not well be changed. Except in a very few instances, the income to be obtained from it would not be increased by raising the rates. In the great majority of instances, to raise the rates would have been to lessen the receipts, while to lower those rates for the purpose of increasing the income by allowing larger importations would have been to remove the protection afforded by them. This was contrary to the avowed policy of the administration. It would, moreover, have served to disturb industry and to perplex its leaders at a time already sufficiently disquieting, and might have proved but an aggravation of the disturbance caused by the war. The great body of the customs rates, of which there are thousands on the tariff schedules, are not productive of much revenue and are not intended to be. They are there to restrict importations. These certainly could not well be changed. Of the bare dozen or so of articles of importation which do yield a revenue, sugar, one of the most important, was likely to

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be interfered with by the war. At the existing rates, sugar imported should yield a revenue of about \$80,000,000 a year, but at least half of the importation was jeopardised by the war itself, and it would have been highly impolitic to have changed the rate of this time. Iron, which was once a source of considerable revenue, was, in consequence of the changes which have taken place in that industry and of the protective features of the customs law, not available to provide new revenues, as the importations are at best small. Cotton goods, the tax upon which yields considerable revenue, were protected; so were manufactures of hemp, flax, and jute, of leather and of wool. Drugs, medicines, and chemicals were already taxed up to the limit of productiveness, from a revenue point of view. In short, there were but four important articles imported which might be used to yield additional revenue. These were hides and skins, raw silk, tea, and coffee. To tax hides and skins or raw silk would, probably, under the prevailing theory of "compensatory" duties, have involved an increase in the rates on the products manufactured from them, to maintain the same degree of protection that those products now enjoy. That would have reopened the whole tariff controversy, and have rendered the outcome of the war revenue measure extremely doubtful. Clearly it were wisest, considering how recently the tariff issue had been temporarily settled, to leave them alone. As a matter

of fact, then, there are only two articles in the whole list of importations which might be considered by the Secretary of the Treasury in his search for new income. These were tea and coffee, which might, perhaps, have been made to yield together nearly \$80,000,000 additional revenue. That was approximately all that could be expected from the tariff.

In the war revenue bill, as presented to the House of Representatives by the committee on ways and means, of which Mr. Dingley was chairman, there was no suggestion of using the tariff in any way for obtaining additional revenue. It was not until the very end of the long discussion of the measure in the Senate that it was proposed to put a duty of ten cents a pound on tea. That measure passed the Senate and was accepted by the conference between the two Houses and by the House of Representatives without any public discussion as to its merits. The reason for this duty, as for the omission of coffee from the list, is therefore not clear. The tax on tea was an important matter. The yield would have been over \$10,000,000 per annum. A similar tax on coffee, which would have been at the rate of 8.5 cents per pound, would have yielded about \$70,000,000 more. It is, therefore, somewhat surprising that it should have attracted so little attention from the members of Congress.

SEC. 7. Since the revenue from the tariff was not to be increased, the only resource available was internal taxes. That these internal taxes should have

taken the same general form as the taxes used during the Civil War, and consequently more or less familiar to people and officers, was but natural. Under the stress of war

The main resource was internal taxation.

it is unwise to attempt to organise entirely new taxes, such, for example, as an income tax. Though an income tax had been used during the Civil War, that form of taxation was under the shadow of an adverse decision from the Supreme Court. Even if an income tax law which would have been constitutional, according to the recent decision of the court, could have been drawn, it is doubtful whether it could have been made productive within any reasonable period of time. Recourse might have been

had to direct taxes, apportioned among the states according to population. These taxes could then have been raised in any manner which the state authorities chose.

An income tax and direct taxes not available.

But there are two fatal objections to this plan. The apportionment of taxes according to population is fundamentally unjust and unequal. What it amounts to practically is a graduated poll-tax. The different commonwealths vary so in wealth *per capita* that any *per capita* tax, however raised, would be unfair. Although the census estimate of wealth in 1890 was anything but satisfactory, yet the method used in that estimate was uniform throughout the country; and such differences as that between South Carolina, with about \$350 *per capita*, and Nevada, with \$4000 *per capita*, show how utterly inadequate

the constitutional method of raising direct taxes has become. Then, again, the method of taxation by which most of the states raise their revenues, and which they would probably follow in raising their share of any apportioned taxes, is the worst in use in any civilised country, and the injustice of the apportionment would have been enormously increased by the injustice in collection. The second objection to this method of raising direct taxes prescribed by the Constitution is that it takes an inordinate length of time, and war taxes should begin to yield a revenue as early as possible.

The only available plan was, therefore, to seek additional revenue from the existing, indirect, inter-

*Description
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taxes.*

nal taxes, the excises or, as they are called in the United States, the "internal revenue" taxes, and to supplement these still further by new taxes of the same sort. Briefly summarised, the revenue bill nearly doubled the existing rate of taxation upon beer and other similar fermented liquors; it imposed special taxes on bankers, brokers, pawnbrokers, theatres, circuses and other shows, bowling-alleys and billiard rooms; it raised the rates on tobacco of all kinds; and it placed stamp taxes on stocks and bonds, commercial papers, legal documents, checks and drafts, proprietary medicines, toilet articles, bills of lading, insurance policies, and a number of other things. Special direct taxes were imposed on the oil trust and the sugar trust, and on legacies and distributive shares of personal property.

SEC. 8. As the war revenue bill passed the House, its probable yield was variously estimated at from \$90,000,000 to \$105,000,000 per annum, *Yield of* the former being the better estimate. As *new taxes.* amended in the Senate and finally adopted, it promised to yield at least \$150,000,000 per annum. The actual yield in addition to the regular revenue during the first month was about \$13,000,000.¹ But the expenses of war during the first few months, if not for a long time after that, would be, it was estimated, at least double that sum and possibly more. Therefore, unless the treasury had a considerable balance on hand, there would have been no possibility of conducting the war at all without immediate loans. The balance in the treasury at the outbreak of the war was \$225,000,000. Upon this were a number of claims, some of *The funds* which, however, were not immediate. *available.* \$100,000,000, known as the gold reserve, had to be held for the preservation of the parity of all parts of the circulation and the avoidance of general financial ruin. Then there were \$13,000,000 of fractional silver and minor coins, a large part of which was

¹ It is not possible, and probably never will be possible, to state exactly how much the new taxes increased the revenues. In the first place the reports do not segregate the income obtained from the new taxes from that obtained from the old; and in the second place the changes in the rates and the existence of new taxes have changed the yield of the older parts of the system by an amount which cannot even be estimated. The total increase in the revenues for the fiscal year 1899 over 1898 was about \$115,000,000.

worn and unavailable, while the rest was needed for currency purposes throughout the country. \$14,000,000 had been received from the sale of the Pacific railroads; but although this sum was temporarily available, it would, if it were spent, be necessary to raise an equivalent amount before January 1 to meet the Pacific Railroad bonds which came due at that time. \$33,000,000 were held in trust for the redemption of the notes of national banks which had failed or which were redeeming their circulation. A part of this was temporarily available, but it would be necessary to replenish that fund at an early date if much were drawn from it. There were, then, out of the \$225,000,000, \$160,000,000, of which a small part only was available, and that but for a short time. Anything drawn upon that would have to be replaced by January 1 at latest. Of the \$65,000,000 remaining, \$40,000,000 were necessary as the cash on hand for the ordinary operations of the government. That amount corresponds to the cash on hand which a merchant keeps in the till to make change or to meet small bills. This left but \$25,000,000 for the initial expenses of the war, which in the state of unpreparedness would naturally be above the average. This \$25,000,000 was all the unincumbered money in the treasury to meet the appropriation of \$50,000,000 made by Congress before war was declared. It was clear that the Secretary of the Treasury could not provide the sinews

of war without the power to borrow, both for a short time, to anticipate the revenues expected from the new taxes, and for a long time, to enable him to support any naval and military operations which might become necessary, however extensive.

SEC. 9. After much discussion and more or less unnecessary and dangerous delay, especially in the Senate, Congress authorised the borrowing, at the discretion of the administration, of not more than \$100,000,000 at one time on treasury certificates and of an amount not to exceed \$400,000,000, on 10-20 bonds at 3 per cent. Nominally, therefore, the Secretary of the Treasury had in his hands for the necessities of war during the first six months of its duration :

Surplus on hand	.	.	.	.	\$ 25,000,000
War revenues	.	.	.	.	75,000,000
Temporary loans	.	.	.	.	100,000,000
Bonds	.	.	.	.	400,000,000
Total	.	.	.	.	\$ 600,000,000

Practically, he was limited by the fact that all of this money had not been appropriated, and it would have been folly to raise more than he had authority to spend. Including the \$50,000,000 appropriated before the war broke out, the total war appropriations made by Congress before it adjourned amounted in all to \$361,788,095.11. This sum covered the most generous estimates of the probable cost of the war.

But the secretary did not deem it necessary to raise at once a sum equal to the total appropriations. It was estimated that the expenses for the first six months would not exceed \$175,000,000, or about one-half of the appropriations. The new taxes would probably yield about \$75,000,000 toward these necessities, and a loan of \$100,000,000 would possibly have sufficed to meet all the demands. But the treasury raised \$200,000,000 by the sale of 3 per cent 10-20 bonds, obtaining a total of \$275,000,000, or nearly \$100,000,000 in excess of the probable actual expenditure. The accumulation of this surplus was not in any sense an extravagant or useless piece of financiering. As has already been explained, the treasury must be prepared to meet any demand that may arise, instantly and amply. That is the imperative necessity. As the early close of the war could not have been foreseen, the fiscal preparations were necessarily liberal. Indeed, the amplitude of the funds available was one of the most potent causes of the success of the war. The excess raised was not larger than was necessary to insure the instant readiness of the treasury to meet all possible demands. Had the war continued and the demands equalled the appropriations, the treasury would again have been obliged to use its power of borrowing which the fortunate termination of the war rendered unnecessary.

SEC. 10. It now remains to see how the credit of

the nation was protected and how it stood the strain. At the end of April, 1898, the interest-bearing debt of the United States amounted in round numbers to \$847,000,000. \$100,000,000 of this bore interest nominally at 5 per cent, the balance at 4 per cent. The 4 per cent bonds, payable in 1925, were quoted when the plans were being made for placing the new loan at 117 $\frac{1}{4}$. At that rate they would yield the investor 3 $\frac{1}{4}$ per cent interest. There was, therefore, some surprise when it was proposed to place the new loan at 3 per cent. It was urged that nobody would buy the new bond at 3 per cent when he could buy one of the old ones and get 3 $\frac{1}{4}$ per cent. Yet the outcome showed the wisdom of the move. The bonds were subscribed to seven times over, and in a short time rose to a premium of 103 and 105. In fact, the entire loan was easily placed on far better terms than any nation has ever before been able to obtain in time of war. This remarkable result was attained partly by reason of the fact that the loan was offered for popular subscriptions and the bonds were for small amounts, thus creating and reaching a new market among investors of small means. In part, too, it was due to the fact that the new bonds at par really formed a better basis for the national bank-note circulation than the old bonds at 117 $\frac{1}{4}$, and very much better than the old bonds at 123 $\frac{1}{4}$, the price which was reached before the new issue was completed. An

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investment by a national bank of \$100,000 in the old bonds at $117\frac{1}{4}$ would yield a profit of \$736.70 on the circulation, if interest is at 6 per cent; while an investment of the same amount in the new bonds at par would yield a profit on the circulation of \$1302.02. The difference in favour of the new bonds was \$565.32, or over half of 1 per cent. The advantage was still greater when the old 4's reached $127\frac{1}{2}$, as they did before the close of the war. None of these influences, however, would have had any weight had it not been that new revenues sufficient to meet all debt charges and part of the war expenses had been provided.

SEC. 11. Much interest centres around the successful attempt to make this a popular loan, and as this was one of the features which contributed to strengthen the credit of the country at this time, we may examine it somewhat in detail. Congress, after much discussion, finally provided that these 3 per cent bonds, "redeemable in coin at the pleasure of the United States after ten years from the date of their issue, and payable twenty years from that date," should "be first offered at par as a popular loan under such regulations, prescribed by the Secretary of the Treasury, as will give opportunity to the citizens of the United States to participate in the subscriptions to such loan, and in allotting such bonds the several subscriptions of individuals shall be first accepted, and the subscriptions for the lowest amounts shall

be first allotted." Before the bill was finally passed, offers had been made by various banking houses to take the whole issue at a slight premium. Both Congress and the administration, however, favoured the experiment of interesting a large number of small property-owners in the loan, even at a loss to the government. It was thought that such a measure would strengthen the national credit by giving expression to the faith of our own people in the integrity of the government. Other considerations of a political character also entered in, but with them we are not concerned. As a financial measure for the strengthening and support of the public credit it proved a phenomenal success.

The bonds were issued in denominations as low as \$20. Subscriptions were received through the post-office, and every *bona fide* subscription under \$500 was immediately accepted. More than half of the entire issue was taken by 230,000 of these small subscriptions, and no subscription of more than \$4500 was accepted. In all 320,000 persons offered or made subscriptions, and the total amount tendered the government was \$1,400,000,000. This rush for the new bonds was not merely a matter of patriotism or sentiment. During the progress of the subscriptions the price of the bonds advanced first to 102 and finally to 105 $\frac{1}{8}$. They now stand at about 110. The lucky individuals whose subscriptions were accepted made from 3 per cent to 5 per cent in a

*The rush
for the new
bonds.*

few days. The popularity of these bonds was greatly enhanced by the standing offers obtained by Secretary Gage from two syndicates to take the entire loan or any part of it that was not covered by the popular subscriptions.

This method of floating the loan will cost the government a considerable sum of money. In the first place a possible premium is lost. How much that premium would have been cannot be estimated because the bonds were sold in a broader market than would have otherwise existed. But it would have been at least 2 per cent, for even at a higher rate the bonds offer a favourable basis for national bank-note circulation. That is, at least \$4,000,000 was lost at the beginning. Then the cost of handling the loan, paying the interest, etc., is increased considerably by the small size of the bonds and the large number of holders. It is just as much trouble to pay the 15-cent coupon of a \$20 bond as it is to pay the \$75 coupon of a \$10,000 bond. Yet in spite of all this, the placing of the \$200,000,000 loan of 1898 was one of the most successful pieces of financiering ever accomplished by the government. It demonstrated the perfect solvency of the government; it gave the country a financial prestige which went a long way toward hastening the end of the war; and it so strengthened credit of the government that, had the war unfortunately continued, it would have been able to obtain funds to almost any amount

*The cost of
the popular
loan.*

on the most favourable terms imaginable. With a 3 per cent bond selling at 105 during the actual continuance of military operations, a nation may safely regard its credit as unimpaired.

The final test of the success of the financial administration of a war is the preservation of the public credit.

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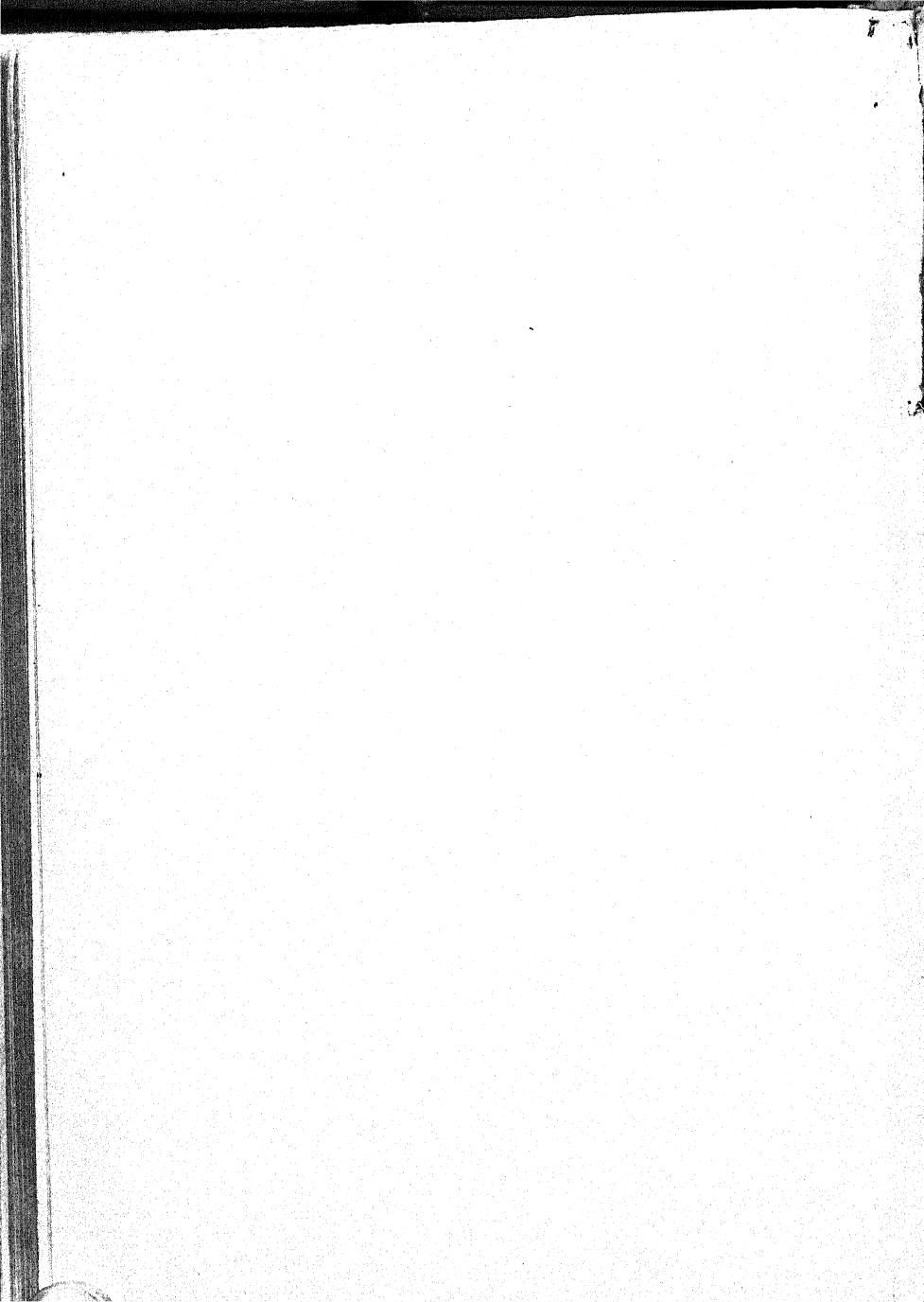
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